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In the Supreme Court of the United States

OCTOBER TERM, 1943.

No. 35.

CITY OF CLEVELAND,
Petitioner,

v.

HOPE NATURAL GAS COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF OF PETITIONER.

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September 27, 1943.

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v.

HOPE NATURAL GAS COMPANY,

Respondent.

**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE FOURTH CIRCUIT.**

BRIEF OF PETITIONER.

This case is here on writ of certiorari, which this Court allowed on May 17, 1943 to review a judgment in favor of the Hope Natural Gas Company entered by the United States Circuit Court of Appeals for the Fourth Circuit—it is true, by a divided vote of its members¹—setting aside the Federal Power Commission's "Order Reducing Rates" and "Findings as to Lawfulness of Past Rates," which were made in a consolidated proceeding under the Natural Gas Act of 1938, wherein the City of Cleveland, the City of Akron, and the Pennsylvania Public Utility Commission, were complainants, and the Federal Power Commission had made an investigation upon its own motion.

The City of Cleveland, petitioner, is especially interested in this review of the judgment of the divided court below, for the reason that the Federal Power Commission's

¹John J. Parker, Senior Circuit Judge; Morris A. Soper, U. S. Circuit Judge; A. M. Dobie, U. S. Circuit Judge, dissenting. (IV R. 207.)

"Order Reducing Rates" and "Findings as to Lawfulness of Past Rates," if valid, constitute an appropriate basis for refunds to the ultimate consumers of natural gas in Cleveland of temporary rates collected under bond by respondent's affiliate, The East Ohio Gas Company² in presently pending proceedings before The Public Utilities Commission of Ohio³ of over \$5,000,000 or an average of about \$20 per customer from June 30, 1939 to June 30, 1943.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals (Parker, Senior Circuit Judge, and Soper, Circuit Judge), together with the dissenting opinion of Dobie, Circuit Judge (IV R. 169-207), is officially reported in 134 F. (2d) 287.

The opinion of the Federal Power Commission (I R. 1-89) is reported in 44 P. U. R. (N. S.) 1.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered on February 16, 1943. (IV R. 207.)

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. Secs. 346 and 347), and as made applicable by Section 19(b) of the Natural Gas Act of 1938. (52 Stat. 831; 15 U. S. C. Sec. 717r(b).)

This Court granted certiorari on May 17, 1943. (*City of Cleveland v. Hope Natural Gas Company*, ... U. S. ..., 63 S. Ct. 1165, 87 L. Ed. 995 (1943); IV R. 210.)

² Both The East Ohio Gas Company and respondent, Hope Natural Gas Company, are wholly-owned subsidiaries of the Standard Oil Company (New Jersey).

³ *East Ohio Gas Company v. City of Cleveland*, P. U. C. O. Nos. 11,001, 11,218, 11,442.

STATUTE INVOLVED.

The statute involved is the Natural Gas Act (52 Stat. 821; 15 U. S. C. Sec. 717, *et seq.*), which became effective June 21, 1938.

The sections of the Natural Gas Act directly involved are Sections 1, 4(a), 5(a), 6, 13, 14(a), 16, 17(c), 19(b), which provide:

Sec. 1. "(a) As disclosed in reports of the Federal Trade Commission made pursuant to S. Rec. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

"(b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas." (15 U. S. C. A. Sec. 717.)

Sec. 4(a). "(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful." (15 U. S. C. A. Sec. 717c (a).)

Sec. 5(a). "(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas

distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates." (15 U. S. C. A. Sec. 717d (a).)

Sec. 6. "(a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

"(b) Every natural-gas company upon request shall file with the Commission an inventory of all or any part of its property and a statement of the original cost thereof, and shall keep the Commission informed regarding the cost of all additions, betterments, extensions, and new construction." (15 U. S. C. A. Sec. 717e.)

Sec. 13. "Any State, municipality, or State commission complaining of anything done or omitted to be done by any natural-gas company in contravention of the provisions of this chapter may apply to the Commission by petition, which shall briefly state the facts, whereupon a statement of the complaint thus

made shall be forwarded by the Commission to such natural-gas company, which shall be called upon to satisfy the complaint or to answer the same in writing within a reasonable time to be specified by the Commission." (15 U. S. C. A. Sec. 717l.)

Sec. 14(a). "(a) The Commission may investigate any facts, conditions, practices, or matters which it may find necessary or proper in order to determine whether any person has violated or is about to violate any provision of this chapter or any rule, regulation, or order thereunder, or to aid in the enforcement of the provisions of this chapter or in prescribing rules or regulations thereunder, or in obtaining information to serve as a basis for recommending further legislation to the Congress. The Commission may permit any person to file with it a statement in writing, under oath or otherwise, as it shall determine, as to any or all facts and circumstances concerning a matter which may be the subject of investigation. The Commission, in its discretion, may publish in the manner authorized by section 825k of Title 16, and make available to State commissions and municipalities, information concerning any such matter." (15 U. S. C. A. Sec. 717m (a).)

Sec. 16. "The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this chapter. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this chapter; and may prescribe the form or forms of all statements, declarations, applications and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify

persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours." (15 U. S. C. A. Sec. 717o.)

Sec. 17(c). "(c) The Commission shall make available to the several State commissions such information and reports as may be of assistance in State regulation of natural-gas companies. Whenever the Commission can do so without prejudice to the efficient and proper conduct of its affairs, it may, upon request from a State commission, make available to such State commission as witnesses any of its trained rate, valuation, or other experts, subject to reimbursement of the compensation and traveling expenses of such witnesses. All sums collected hereunder shall be credited to the ~~appropriation~~ from which the amounts were expended in carrying out the provisions of this subsection." (15 U. S. C. A. Sec. 717p (c).)

Sec. 19(b). "(b) Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the

Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of Title 28, as amended." (15 U. S. C. A. Sec. 717r (b).)

QUESTIONS PRESENTED.

1. Whether, for rate-making purposes under the Natural Gas Act, the Commission is authorized to use a rate base determined exclusively upon the basis of "prudent investment" measured by actual legitimate cost less depreciation, or whether it must use a rate base which reflects estimates of the extent and effect of post-investment fluctuations in labor and material prices.

2. Whether the Commission must include in actual legitimate cost amounts previously and correctly charged to operating expenses, in accordance with industry practice

of the time, and determined by the Commission to have been recouped through revenues from the rate payers.

3. Whether the lower court erred in holding that in determining the actual existing or accrued depletion and depreciation, the Commission failed to take into account "the present condition of the property."

4. Whether the Commission may determine actual existing or accrued depletion and depreciation, and the annual allowance in operating expenses for these factors, upon the basis of actual legitimate cost, or whether the Commission ~~must base~~ such determinations upon estimates of "present fair value" of the property.

5. Whether the economic-service-life principle, as applied by the Commission in this case, is a reasonable method of determining the actual existing depletion and depreciation and the annual allowance therefor.

6. Whether the lower court erred in holding that \$165,965 for an experimental deep-test well, which was completed dry and charged to operating expenses in 1941, should have been included in 1940 operating expenses.

7. Whether the rates fixed by the Commission are just and reasonable in the statutory sense and nonconfiscatory in the constitutional sense.

8. Whether the Commission has jurisdiction to determine the **lawful** rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order.

9. Whether the lower court erred in holding that the Commission's "findings as to past rates * * * should be set aside."

STATEMENT.**1. The respondent.**

Hope Natural Gas Company, a wholly owned subsidiary of the Standard Oil Company (New Jersey), is conceded to be a "natural-gas company" within the meaning of the Natural Gas Act. (III R. 19.) Hope purchases and produces natural gas in West Virginia, transports it in pipe lines to the West Virginia-Ohio and West Virginia-Pennsylvania state lines, and there sells it in interstate commerce to its affiliates East Ohio Gas Company and River Gas Company for resale to ultimate consumers in Ohio; to its affiliate Peoples Natural Gas Company for resale to ultimate consumers in Pennsylvania; and to the nonaffiliated Manufacturers Light and Heat Company and Fayette County Gas Company for resale to ultimate consumers in Pennsylvania. (I R. 106-110.) East Ohio, River and Peoples, like Hope, are 100 per cent owned subsidiaries of the Standard Oil Company (New Jersey). (I R. 106.) About 85 per cent of Hope's total sales are in interstate commerce and 95 per cent of such sales are to its aforementioned affiliates—East Ohio, River, and Peoples. About 15 per cent of Hope's total volume of gas is sold in intrastate commerce to local consumers in West Virginia. (I R. 18.) Hope has been purchasing, producing, transporting and selling natural gas for more than forty years. Hope's interstate sales in 1940 amounted to about 53,000,000 M.c.f. and its interstate gross revenues in that year amounted to \$19,296,000. (I R. 51.)

2. The proceedings before the Commission.

The proceedings before the Commission were initiated by the filing of the complaint by the City of Cleveland against Hope Natural Gas Company in Docket No. G-100 on July 6, 1938. Cleveland's was the first complaint filed under the Natural Gas Act, which became effective on June 21, 1938.

The material allegations of the complaint of the City of Cleveland may be shortly stated. (II R. 1.) The complainant City of Cleveland is an Ohio municipal corporation and a municipality within the meaning of the Natural Gas Act. (Cleveland Complaint, par. first.) The defendant Hope Natural Gas Company is a West Virginia corporation engaged in the sale of natural gas in interstate commerce. (Cleveland Complaint, par. second.) The defendant Hope is a wholly owned subsidiary of the Standard Oil Company (New Jersey). (Cleveland Complaint, par. third.) Defendant Hope sells gas produced in West Virginia and delivers said gas to its affiliate, The East Ohio Gas Company, likewise a wholly owned subsidiary of the Standard Oil Company (New Jersey), at the Ohio River. (Cleveland Complaint, par. third.) The interest of the City of Cleveland in this proceeding arises because East Ohio, which is the only company distributing natural gas in Cleveland, purchases approximately 70 per cent of the gas which it merchandises in Cleveland and other municipalities in Ohio from its affiliate, the defendant Hope. (Cleveland Complaint, par. third.) Under an intercorporate contract between defendant Hope and East Ohio, East Ohio pays to Hope annually a total of approximately \$13,000,000. (Cleveland Complaint, par. fourth.) In a proceeding then pending before The Public Utilities Commission of Ohio, Hope's affiliate, East Ohio, was then seeking to use the rate paid to Hope under the initial schedule filed by Hope with the Federal Power Commission, to support a claim that an ordinance rate of the City of Cleveland for the two years ending June 30, 1939, suspended by the filing of a bond, should be permanently set aside, and that higher rates should be imposed upon the consumers of gas in Cleveland than would otherwise be allowable. (Cleveland Complaint, par. sixth.) The complaint further alleged that, in any event, a determination by the Federal Power Commission of the fair,

just and reasonable rate for gas sold by Hope to East Ohio at the Ohio River, was essential to the determination of a fair, just and reasonable rate for natural gas to be sold in Cleveland during the next ordinance period beginning June 30, 1939. (Cleveland Complaint, par. sixth.) Cleveland alleged on that sixth day of July, 1938, that the price charged by Hope to East Ohio for gas for resale in Cleveland and elsewhere is excessive, unjust and unreasonable. (Cleveland Complaint, par. fifth.)

On January 6, 1939, the City of Cleveland filed an amendment to its complaint. (II R. 14-15.) The amendment pointed out that pursuant to Section 14(a) of the Act the Federal Power Commission has authority to investigate any facts, conditions, practices, or matters which it may find necessary or proper in order to determine whether any person has violated or is about to violate any provision of the Natural Gas Act. (Cleveland Amendment, par. first.) It suggested that pursuant to Section 14(a), the Federal Power Commission is specifically authorized to make available to state commissions and municipalities, information concerning any such matter. (Cleveland Amendment, par. second.) The Cleveland Amendment further averred that under Section 4(a) of the Natural Gas Act, all rates and charges made, demanded or received by any natural gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission must be just and reasonable and any such rate that is not just and reasonable is unlawful, and has been unlawful ever since the effective date of the Natural Gas Act on June 21, 1938. (Cleveland Amendment, par. third.) It urged that Congress had thus specifically authorized the Commission to investigate and determine whether the charges made by Hope Natural Gas Company and payments received from The East Ohio Gas Company were unjust, unreasonable and therefore contrary to Federal law, as of June 21, 1938, the effective date of the Natural Gas Act, and at all times subsequent thereto.

(Cleveland Amendment, par. fourth.) This amended complaint was itself filed under authority of Section 13 of the Natural Gas Act, which permits only a State, a municipality, or a State commission to file a complaint against anything done or omitted to be done by any natural gas company in contravention of the provisions of the Natural Gas Act. The Amendment to Cleveland's complaint specifically alleged that the price charged by Hope to East Ohio for natural gas on June 21, 1938, and has been at all times since excessive, unjust and unreasonable, at least in so far as said price has exceeded an average of 30 cents per M.e.f., and therefore was as of June 21, 1938, and has been at all times since, unlawful and contrary to the laws of the United States. (Cleveland Complaint, par. sixth.) The Federal Power Commission was urged to make the determination upon the ground that under the Natural Gas Act, Section 1, the only body which can determine in the first instance whether the price charged by Hope to East Ohio and received by Hope from East Ohio has been unlawful and contrary to the laws of the United States is the Federal Power Commission. (Cleveland Complaint, par. seventh.) The City's Amendment to Complaint asserted finally that a determination by the Federal Power Commission in accordance with the prayer of this amendment should be of assistance in the cases of Cleveland and other Ohio municipalities then pending before The Public Utilities Commission of Ohio, in that the reasonableness of the suspended ordinance rate in Cleveland for the two year period ending June 30, 1939, is ultimately dependent upon the lawfulness of the charge made by Hope Natural Gas Company to The East Ohio Gas Company at the Ohio River, and in the case of the affiliated *East Ohio Gas Company v. Cleveland*, then pending before The Public Utilities Commission of Ohio, no allowance can be made in the operating expenses of East Ohio which is unlawful either for the affiliated buyer to pay or for the affiliated seller to charge or receive. (Cleveland Amendment to Complaint, par. seventh.)

At the trial before the Commission, the City's amended complaint was modified. (Reply Brief of City of Cleveland before Federal Power Commission, filed September 30, 1941.) The City reported that during the Federal Power Commission's investigation and hearings in the Hope case, the Ohio Commission had decided the related *East Ohio Gas Company* case involving Cleveland natural gas rates for the two year period ended June 30, 1939. (*East Ohio Gas Company v. Cleveland*, 27 P. U. R. (N. S.) 387 (decided January 10, 1939); aff'd *The East Ohio Gas Company v. Public Utilities Commission of Ohio* (two cases), 137 O. S. 225 (1940).) Hence the City conceded that the lawfulness of the Hope-East Ohio rate from June 21, 1938 to June 30, 1939 had become moot. However, Cleveland further advised the Federal Power Commission that by reason of the pendency of another East Ohio appeal to the Ohio Commission from a later Cleveland rate ordinance, the ownership of moneys collected under bond by East Ohio in Cleveland since June 30, 1939, was still in issue in 1941 under the retroactive rate-fixing powers of the Ohio Commission. (Ohio General Code, Sec. 614.44-614.47, both inclusive.) (*East Ohio Gas Company v. Cleveland*, P. U. C. O. Nos. 11,001; 11,218 and 11,442.) Therefore, the City modified its complaint as amended by relating its charge that Hope had violated the Natural Gas Act, Section 4(a) by charging East Ohio an unreasonable rate and by not charging East Ohio a reasonable rate, only to the period since and after June 30, 1939. (Reply Brief of City of Cleveland before Federal Power Commission filed September 30, 1941.)

The Complaint of the City of Cleveland, as so amended and modified, thus prayed (1) for an investigation by the Federal Power Commission, a finding that the Hope-East Ohio rate is excessive and unreasonable, and for the fixing of a just, fair and reasonable rate for the future; (2) that the Commission determine separately in aid of state regulation that the Hope-East Ohio rate has been unjust, un-

reasonable and unlawful from June 30, 1939 to the date of its determination, and that the Commission further determine that a reasonable Hope-East Ohio rate for such period was not more than 30 cents per M.c.f.

The allegations of Cleveland's complaint as amended were put in issue by the answer of Hope Natural Gas Company to complaint of the City of Cleveland, filed August 18, 1938 (II R. 3) and by the answer of Hope Natural Gas Company to amendment to complaint of the City of Cleveland filed February 6, 1939. (II R. 16.)

A complaint against Hope similar to that filed by the City of Cleveland was filed by the City of Akron in July of 1938, charging that the rate collected by Hope from East Ohio was excessive and unreasonable. (II R. 7.) In October, 1938, the Federal Power Commission, on its own motion, instituted an investigation to determine the reasonableness of all Hope's interstate rates. (II R. 28.) In March, 1939, the Pennsylvania Public Utility Commission filed a complaint with the Federal Power Commission, charging that the rates collected by Hope from Peoples Natural Gas Company, Manufacturers Light and Heat Company, and Fayette County Gas Company, were unreasonable. (II R. 18.) In October, 1939, the Federal Power Commission consolidated the three complaint cases and its own investigation of Hope's interstate wholesale rates for hearing. (II R. 34.) On December 20, 1940, the Commission denied without prejudice a motion of the Cities of Cleveland and Akron for an immediate order reducing the Hope-East Ohio rate upon the Hope company's own testimony, upon the ground that "there is insufficient evidence of record, at this time, to support the prayer for relief requested by movants," and subject to the reservation that "this order is not to be construed as a determination of any of the issues in the pending principal proceeding." (II R. 43.) Hearings were held in 1940 and 1941, and after briefs were filed, the case was argued orally before the Commission sitting *en banc* on October

27, 1941. (II R. 48.) The Commission decided the case on May 26, 1942 (I R. 1, 8) when it entered its "Order Reducing Rates" charged by Hope and in addition, made separate "Findings as to Lawfulness of Past Rates" collected by Hope from East Ohio.

3. The Commission's Determinations.

The Commission's "Order Reducing Rates" required Hope to reduce its interstate rates for the future to reflect a reduction of not less than \$3,609,857 in operating revenues on an annual basis. (I R. 6.) More particularly, the order required minimum reductions of 7 cents per M.c.f. from the 36.5 cent and 35.5 cent rates previously charged the affiliates, East Ohio and Peoples, respectively, and 3 cents per M.c.f. from the 31.5 cent rate previously charged the non-affiliates, Fayette County and Manufacturers Light and Heat. (I R. 3-74.) The Commission's "Findings as to Lawfulness of Past Rates," made in deciding the complaint of the City of Cleveland, determined that the rates collected by Hope from East Ohio were unjust, unreasonable, excessive, and therefore unlawful, by \$830,892 in 1939, \$3,219,551 during 1940 and \$2,815,789 on an annual basis since 1940; it further determined just, reasonable and lawful rates for gas sold to East Ohio for resale for ultimate public consumption to be \$11,528,608 for 1939, \$11,507,185 for 1940 and \$11,910,947 on an annual basis for 1941 and the first half of 1942. (I R. 12-13.)

The Commission founded its "Order Reducing Rates" upon a rate base of \$33,712,526, upon which it granted respondent a 6½ per cent rate of return (I R. 4), or \$2,191,314, annually. The rate base was determined to be the actual legitimate cost of, or gross investment in, Hope's interstate property less existing depletion and depreciation, plus allowances for unoperated acreage, working capital and future net capital additions. (I R. 50.)

The Commission's rate base was arrived at substantially as follows: The Commission found that Hope had

kept complete documentary evidence, through books, records and vouchers, of its expenditures throughout its existence, so that no estimates were required to ascertain the actual legitimate cost. (I R. 23, 174.) Pursuant to a check of the inventory of Hope's property in service and examination, analysis and audit of respondent's records, the Commission determined the cost to be \$52,174,873 for the property devoted to the interstate sales, as of December 31, 1940. (I R. 36.) From this amount, the Commission then deducted accrued depletion and depreciation, which it found to be \$22,328,016. (I R. 45-50.) It arrived at this figure by applying the economic-service-life method to actual legitimate cost. (I R. 41.) In making these determinations the Commission was guided by a study conducted by a qualified staff engineer, who made a field inspection of the Company's physical properties to aid in the determination of service lives. (I R. 42.) The actual existing depletion and depreciation found by the Commission came to about \$24,000,000 less than the depletion and depreciation which the Company had accrued on its books. (I R. 81.) One of the Commissioners dissented on the ground that the Commission should have deducted accrued depreciation and depletion of not less than \$38,000,000, the reserve remaining on the Company's books after it had transferred \$7,500,000 from the reserve to surplus. (I R. 81.) The Commission then added \$1,392,021 for future net capital additions, \$566,105 for useful unoperated acreage and \$2,125,000 for working capital, yielding the total rate base of \$33,712,526. (I R. 50.)

Using 1940 as a test year to forecast future revenues, and forecasting expenses at the 1940 figure plus \$421,160, the Commission allowed respondent operating expenses and taxes amounting to \$13,495,584. (I R. 62, 70, 72.) Of this total \$1,460,037 represented the annual allowance for depreciation and depletion. (I R. 53.) This allowance was determined by the Commission in the same way as the actual existing depreciation and depletion, by the

application of the economic-service-life method to the actual legitimate cost of respondent's properties. (I R. 51-52.)

The Commission's "Findings as to Lawfulness of Past Rates" were arrived at on the same principles and in substantially the same manner as the "Order Reducing Rates," except that they were based on actual operating experience for the years in question, instead of a test year. (I R. 11.)

In issuing its order and findings the Commission rejected respondent's argument that post investment changes in price levels had to be reflected in the rate base and in computing both accrued depreciation and depletion and the annual allowance in operating expenses for depreciation and depletion. (I R. 20-23, 36, 41, 52.) It condemned as hypothetical and without probative value the "reproduction cost new" and "trended original cost" estimates (amounting to approximately \$97,000,000 and \$105,000,000 respectively) submitted in evidence by respondent in support of its claimed rate base of some \$66,000,000. (I R. 20-23.) The Commission also rejected respondent's contention that, in any event, the rate base should have reflected an additional sum of about \$17,000,000, representing largely expenditures for well-drilling prior to 1923, which respondent had charged to operating expense. (I R. 24-34.) Likewise unsuccessful were respondent's espousal of the "per cent condition" theory of measuring accrued depreciation (I. R. 38), its claim that an expenditure of \$165,965 for a deep-test well, which was completed dry and charged to operating expenses in 1941, should have been included in 1940 operating expenses, and its argument that the annual allowance for depletion and depreciation should take account of the capital additions recognized after 1940.

Pursuant to Section 19 of the Act, Hope filed an application for rehearing (II R. 51), and upon denial, petitioned the United States Circuit Court of Appeals for the Fourth Circuit for a review of the Commission's "Order

Reducing Rates" and the Commission's "Findings as to Lawfulness of Past Rates," naming the Federal Power Commission, the City of Cleveland, the City of Akron, and the Pennsylvania Public Utility Commission as parties respondent. (IV R. 1.) Hope did not seek a stay of the Commission's order from the Court of Appeals and such order has not been stayed; instead Hope agreed with its customer companies to charge the ordered rates pending litigation, upon the customers' agreement to make Hope whole if the Commission's order should be finally invalidated.

4. The Opinion Below.

On review, the court below, with one judge dissenting, set aside the Commission's "Order Reducing Rates" on the basic grounds that: (1) the Commission's use of a prudent investment rate base failed to reflect "present fair value," in view of the post investment, "decided change in price levels" shown by the record and judicially noticeable (IV R. 172, 184); (2) the Commission erroneously excluded from the rate base the well-drilling costs charged to operating expenses prior to 1923 (IV R. 172, 184-189); (3) the Commission improperly determined accrued depreciation on the basis of "mere formulas," without considering the present physical condition of respondent's property (IV R. 172, 190); (4) the Commission should have based its annual allowance in operating expenses for depreciation and depletion upon the "present fair value" of the physical property, instead of upon actual legitimate cost (IV R. 194-196); (5) the Commission should have included in 1940 operating expenses \$165,963 for an experimental deep-test well, which was completed dry and charged to operating expenses in 1941 (IV R. 198); (6) the Commission should have made an annual allowance for depreciation and depletion on capital added to the rate base after 1940. (IV R. 196.)

The lower court also set aside the Commission's "Findings as to Lawfulness of Past Rates," holding (1) that the Commission had no jurisdiction to make findings as to the lawfulness of past rates "to be given effect in rate proceedings before state commissions," and that rates filed with the Commission under Section 4(c) of the Act became the only "lawful" ones which the utility could charge or accept until changed by the Commission; (2) that the Commission could investigate "the conditions and rates of the past" as an incident of its power to fix future rates, but that so viewed the findings in question were invalid for the same reasons as its "Order Reducing Rates," and were also objectionable in that they were based on actual experience for the years in question, rather than reasonable estimates of expenses based on experience during a prior period. (IV R. 203.) The Court further held that if the Commission has jurisdiction to determine lawful rates for a period subsequent to the passage of the Natural Gas Act and prior to the making of an order fixing future rates, its determination is, in effect, an order of the Commission affecting substantial rights and contractual relationships of a party to a proceeding before it and is reviewable as such. (IV R. 203.) On March 8, 1943, the Circuit Court granted a motion for the stay of its mandate pending further order, upon the condition that a petition for writ of certiorari be filed with the Supreme Court of the United States within thirty days. (IV R. 208.)

SPECIFICATION OF ERRORS TO BE URGED.

1. The Court of Appeals erred in holding that for rate-making purposes under the Natural Gas Act, the Commission is not authorized to use a rate base determined exclusively upon the basis of "prudent investment" measured by actual legitimate cost less depreciation, but that it must use a rate base which reflects estimates of the extent and effect of post investment fluctuations in labor and material prices.

2. The Court of Appeals erred in holding that the Commission must include in actual legitimate cost amounts previously and correctly charged to operating expenses, in accordance with industry practice of the time and determined by the Commission to have been recouped through revenues from the rate payers.

3. The Court of Appeals erred in holding that in determining the actual existing or accrued depletion and depreciation, the Commission failed to take into account "the present condition of the property."

4. The Court of Appeals erred in holding that the Commission may not determine actual existing or accrued depletion and depreciation, and the annual allowance in operating expenses for these factors, upon the basis of actual legitimate cost, but that the Commission must base such determinations upon estimates of "present fair value" of the property.

5. The Court of Appeals erred in holding that the economic service-life principle, as applied by the Commission in this case is not a reasonable method of determining the actual existing depletion and depreciation and the annual allowance therefor.

6. The Court of Appeals erred in holding that \$165,963 for an experimental deep-test well, which was completed dry and charged to operating expenses in 1941, should have been included in 1940 expenses.

7. The Court of Appeals erred in holding that the rates fixed by the Commission are not just and reasonable in the statutory sense and are confiscatory in the constitutional sense.

8. The Court of Appeals erred in holding that the Commission has no jurisdiction to determine the lawful rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order.

9. The Court of Appeals erred in holding that the Commission's "Findings as to past rates * * * should be set aside."

SUMMARY OF ARGUMENT.

I.

The Court of Appeals erred in holding that the Commission's "Order Reducing Rates" and "Findings as to Lawfulness of Past Rates" are unconstitutional, for the reason, among others, that there is no constitutional question involved in this case.

No person is deprived of property and there is no taking of private property within the meaning of the Fifth Amendment. By reason of the 100 per cent common ownership of respondent and respondent's principal customers by the Standard Oil Company (New Jersey), neither the Federal Power Commission's "Order Reducing Rates" nor its "Findings as to Lawfulness of Past Rates" substantially reduces, without further administrative action, the system's revenues or the annual return available to the owner of the business.

II.

The Court of Appeals further erred in setting aside the Federal Power Commission's "Order Reducing Rates," for the reason that said order is authorized by the Natural Gas Act, and is based upon findings which have a rational basis and are supported by substantial evidence.

The Court of Appeals erred in holding that for rate-making purposes under the Natural Gas Act, the Commission is not authorized to use a rate base determined exclusively upon the basis of "prudent investment" measured by actual legitimate cost less the depreciation therein but that it must use a rate base which reflects estimates of the extent and effect of post investment fluctuations in labor and material prices. The Natural Gas Act does not provide

either expressly or by necessary implication that the lowest just and reasonable rate which the Commission may fix is one which yields a reasonable return upon the "present value" of the physical property. Under the Natural Gas Act, the selection of an appropriate rate base is a matter of sound discretion for the Federal Power Commission. The Commission's selection of a rate base determined exclusively upon the basis of "prudent investment" measured by actual legitimate cost less the depreciation therein was a reasonable exercise of discretion.

The Court of Appeals erred in holding that the Commission's findings of actual legitimate cost, the depreciation therein, the annual allowance for depreciation, and the dry hole as an operating expense of 1941, were not conclusive upon the court since each of said findings has a rational basis and is supported by substantial evidence.

III.

Even if there were a constitutional question involved, as there is not, the Court of Appeals further erred in setting aside the Federal Power Commission's "Order Reducing Rates" for the reason that in the absence of an exercise of the power of eminent domain or other direct appropriation of property for the use of the United States Government, respondent was not entitled under the Fifth Amendment to anything more than due process of law.

IV.

The Court of Appeals erred in holding that the Federal Power Commission has no jurisdiction to determine the lawful rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order for the reason that said jurisdiction is implied from expressly granted powers, and is supported by the legislative history of the statute.

The jurisdiction of the Commission to determine lawful rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order is implied from the expressly granted power to determine upon complaint of a municipality and upon the Commission's own investigation that the Act has been violated by charging an unlawful rate and by not charging a lawful rate.

The power to determine a reasonable and lawful rate for a reasonable period antedating the Commission's first order fixing rates for the future is implied from the expressly granted power to fix reasonable future rates.

The holding of the Court of Appeals that the Federal Power Commission is without jurisdiction to determine lawful rates for a period subsequent to the passage of the Natural Gas Act and prior to an initial rate-fixing order thwarts and defeats the intent and purpose of Congress.

V.

The Court of Appeals further erred in holding that the Commission's "Findings as to Lawfulness of Past Rates" should be set aside even if the Commission has jurisdiction to make such findings, for the reason that said findings have a rational basis and are supported by substantial evidence.

ARGUMENT.

I.

THE COURT OF APPEALS ERRED IN HOLDING THAT THE COMMISSION'S "ORDER REDUCING RATES" AND "FINDINGS AS TO LAWFULNESS OF PAST RATES" ARE UNCONSTITUTIONAL, FOR THE REASON, AMONG OTHERS, THAT THERE IS NO CONSTITUTIONAL QUESTION INVOLVED IN THIS CASE.

No person is deprived of property and there is no taking of private property within the meaning of the Fifth Amendment.

By reason of the 100 per cent common ownership of respondent and respondent's principal customers by the Standard Oil Company (New Jersey), neither the Federal Power Commission's "Order Reducing Rates" nor its "Findings as to Lawfulness of Past Rates" substantially reduces, without further administrative action, the system's revenues or the annual return available to the owner of the business.

Contrary to the holding of the court below (IV R. 1847) there is no question of confiscation under the Fifth Amendment involved in this case.

A regulation of the rates of a corporation can deprive a person of property within the meaning of the Fifth Amendment only by reducing the earnings available for interest to bondholders and dividends to stockholders. *Chicago, etc., Railway Company v. Wellman*, 143 U. S. 339, 345 (1892) (Mr. Justice Brewer).

In *McCart v. Indianapolis Water Company*, 302 U. S. 419, 433-434 (1938), Mr. Justice Black, dissenting, said:

"The doctrine against confiscatory rates is based upon the theory of protecting the right of bondholders to their interest and that of stockholders to a fair return upon the value of their actual investments. While this matter has been confused by the 'reproduction cost' theory, the fact remains that, as applied to corporations, it is the interest of the stockholders and bondholders which the due process clause protects."

Where the seller and purchaser are corporations owned by the same stockholder, and there are no bondholders, a reduction in rates of the seller alone reduces *pro tanto* the costs of the purchaser, and there is no deprivation of property, because no reduction in the earnings available for dividends to the stockholder. The Federal Power Commission under the Natural Gas Act, unlike the Interstate Commerce Commission under the Interstate Commerce Commission Act and the Federal Communications Commission under the Federal Communications Commission Act, does not by its order control the rate which the public shall pay. Under the Natural Gas Act, the regulation of local distribution rates is left to the states. (Natural Gas Act, Section 1(b), *supra*, p. 3.)

A mere division order of the Interstate Commerce Commission does not take private property for the public. See *B. & O. Railroad Company v. United States*, 298 U. S. 349 (1936), concurring opinion of Justices Brandeis, Stone, Roberts, and Cardozo, pages 382-383. With even greater force it may be said that an order of the Federal Power Commission reducing rates charged by a 100 per cent owned subsidiary to another 100 per cent owned subsidiary of the same holding company does not take private property for the public. That is this case.

The Federal Power Commission's "Order Reducing Rates" in this case does not, standing alone, without further administrative action, substantially reduce the annual return available for dividends to respondent's sole stockholder, Standard Oil Company (New Jersey). *A fortiori*, the Federal Power Commission's "Findings as to Lawfulness of Past Rates" do not, in the absence of further administrative action, reduce the annual return available to respondent's sole stockholder.

Respondent, Hope Natural Gas Company, is wholly owned by the Standard Oil Company (New Jersey). (*Supra*, p. 9.) The three principal interstate customer companies of respondent, namely The East Ohio Gas Company,

Peoples Natural Gas Company, and River Gas Company, are likewise wholly owned by the Standard Oil Company (New Jersey). (*Supra*, p. 9.) The Federal Power Commission's "Order Reducing Rates" of respondent, Hope Natural Gas Company, reduces *pro tanto* the operating costs of petitioner's affiliates, East Ohio, Peoples, and River, and increases *pro tanto* the return available for dividends to Standard from these affiliates, unless and until some action is taken by a state commission which reduces the revenue received by the system from the gas consuming public.

Respondent conceded in its brief before the United States Circuit Court of Appeals for the Fourth Circuit that "to have either reductions or increases in gas rates reflected to consumers requires not merely the approval of the Federal Power Commission but of the state commission" (*Hope Natural Gas Company v. Federal Power Commission, et al.*, C. C. A. 4, No. 4979, Brief of Petitioner, Hope Natural Gas Company, p. 118.) As to the three principal interstate customers of respondent, the Federal Power Commission's "Order Reducing Rates" does not therefore reduce the annual return available for dividends to respondent's sole stockholder Standard Oil Company (New Jersey).

The inconsequential reduction in respondent's rates to The Manufacturers Light and Heat Company and the Fayette County Gas Company, which are not owned by the Standard Oil Company (New Jersey), included in the Commission's "Order Reducing Rates," does not reduce the total return available for dividends to the Standard Oil Company (New Jersey) in an amount sufficient to lay any ground for a claim of confiscation.

The Federal Power Commission's "Order Reducing Rates," standing alone, thus reduces the annual return available for dividends for respondent's sole stockholder Standard Oil Company (New Jersey) in a total

amount of not to exceed \$55,815 per year. (I R. 6, 51.)¹ This reduction of the annual return available for dividends to Standard Oil, being only 8/100 of one per cent of respondent's claimed rate base of \$66,000,000, constitutes no basis for invoking the Fifth Amendment to the Constitution of the United States. The respondent's petition for review made no complaint of the absence of an allocation as between the affiliated and nonaffiliated customers (IV R. 1-42), and petitioner has no basis for a claim that the 3 cents per M.e.f. reduction in the nonaffiliated Manufacturers and Fayette County rate (as compared with the 7 cent reduction in rates to affiliates Peoples and East Ohio) is separable from the effect of the order as a whole, and no such claim has been made. Cf. *Puget Sound Traction Co. v. Reynolds*, 244 U. S. 574, 579-80 (1917) (Mr. Justice Pitney).

For the court below to invoke the Fifth Amendment at this time is at least premature. See *Dayton Power and Light Company v. Public Utilities Commission of Ohio*, 292 U. S. 398, 414-5, (1934) (Mr. Justice Cardozo).

The court below erroneously concluded that a question of confiscation was involved, because the Federal Power Commission's order in this case manifestly works no deprivation of property of any person within the meaning of the Fifth Amendment to the Constitution of the United States.

"The Constitution," as Mr. Justice Holmes once said, "is not to be satisfied with a fiction." *Hyde v. United States*, 225 U. S. 347, 390 (1912) (Mr. Justice Holmes, dissenting).

**¹Reduction of Net Income after Federal Income Taxes from
Nonaffiliated Companies**

	Before Reduction	After Reduction	Reduction
Fayette Manufacturers	\$270,618 706,131	\$244,845 638,880	\$25,773 67,251
Total Income Tax 40%	\$976,749	\$883,725	\$93,024 37,209
Reduction in Net Income after Fed. In. Tax			\$55,815

II.

THE COURT OF APPEALS FURTHER ERRED IN SETTING ASIDE THE FEDERAL POWER COMMISSION'S "ORDER REDUCING RATES" FOR THE REASON THAT SAID ORDER IS AUTHORIZED BY THE NATURAL GAS ACT, AND IS SUPPORTED BY SUBSTANTIAL EVIDENCE.

- A. The Court of Appeals erred in holding that for rate-making purposes under the Natural Gas Act, the Commission is not authorized to use a rate base determined exclusively upon the basis of "prudent investment" measured by actual legitimate cost less the depreciation therein, but that it must use a rate base which reflects estimates of the extent and effect of post investment fluctuations in labor and material prices.**

It is conceded that the Commission gave no weight to the Company's evidence of post-investment changes in labor and material prices. The question presented is whether the statute requires the Commission to give some, if not controlling weight, to evidence of reproduction or trended original cost or other evidence of "present value" of the physical property in arriving at a rate base.

- 1. The Natural Gas Act does not provide either expressly or by necessary implication that the lowest just and reasonable rate which the Commission may fix is one which yields a reasonable return upon the "present value" of the physical property.**

The court below erroneously concluded that under the Natural Gas Act, the lowest just and reasonable rate which the Commission may fix is one which yields a reasonable return upon the "present value" of the physical property of the natural gas company. (IV R. 174-180.)

Sections 5(a) and 6(a) of the Natural Gas Act provide:

Sec. 5(a) "(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or col-

lected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates."

Sec. 6(a) "(a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property."

The statute manifestly does not provide that the lowest just and reasonable rate which the Commission may fix is one which yields a reasonable return upon the "present value" of the physical property of a natural gas company. Section 5(a) merely provides that the rates fixed by the Commission shall be just and reasonable. It sets up no standard beyond that. *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575 (1942) (concurring opinion of Black, Douglas and Murphy, JJ., at page 606).

Section 6(a) does not require the Commission to determine present value. It does not require the Commission to determine prudent investment. It does not require the Commission to determine fair value. It does not require

the Commission to determine any rate base. The language of the section is wholly permissive. The Commission "may" investigate and ascertain the actual legitimate cost of the property of every natural gas company and depreciation therein. The Commission "may" ascertain and determine other facts only "when found necessary for rate-making purposes." In the absence of such a finding of necessity, the statute does not in terms even permit the Commission to ascertain and determine "other facts which bear on the determination of such cost or depreciation and the fair value of such property." This is the single plain meaning of the statute.

The legislative history of the companion section of the Federal Power Act, enacted as Section 208 of Title 2 of the Public Utility Act of 1935, supports and confirms this single plain meaning of Section 6(a) and Section 5(a) of the Natural Gas Act. In adopting the Federal Power Act, Congress rejected an amendment offered by Senator Bailey, requiring the use of "fair value" as the rate base. (79 Cong. Rec. 8858.) In adopting the Federal Power Act, Congress also rejected a draft which provided that in determining just and reasonable rates, the Commission shall fix a rate base "not in excess of the actual legitimate cost of the property used and useful for the service in question, less the depreciation therein." Section 208 of Title 2 of the Public Utility Act of 1935; Sec. 208 of S. 2796, 74th Cong. First Session; Senate Report No. 621, 74th Cong. First Session, p. 52; 79th Cong. Rec. 9065; Senate Report No. 621, 74th Cong. First Session, p. 20; House Report No. 1318, 74th Cong. First Session, p. 30. The legislative history thus supports the conclusion apparent on the face of the Natural Gas Act that Congress did not intend to impose upon the Federal Power Commission as a mandatory requirement the use of "present value" or any other rate base formula.

Even if the word "may" used in Section 6(a) of the Natural Gas Act were interpreted to mean "shall," the

statute could not be construed to require the Commission to base rates on "present value."

As the Special Committee of the Public Utility Law section of the American Bar Association said in its report to the annual meeting of the association in September, 1940 (1940 Report of the American Bar Association, pp. 14-15) (quoted in *City of Detroit v. Panhandle Eastern Pipe Line Company*, 45 P. U. R. (N. S.) 203 (September 23, 1942)):

"It will be noted that the primary duty of the Commission under these two provisions (Fed. Power Act, Sec. 208, Natural Gas Act, Sec. 6) is to ascertain the cost of the property and the depreciation therein, and that 'other facts which bear on the determination of such cost or depreciation, and the fair value of such property' are to be determined only 'when found necessary for rate making purposes.' There is here the possible inference that the Congress, when it drafted this provision, was hopeful that the courts would decide that nothing other than the 'actual legitimate cost' of the property would be 'found necessary for rate making purposes.' However that may be it is patent that an accounting or cost rate base was dominant in the congressional mind, and that these very recent statutes in that respect are the very antithesis of some of the older state statutes which prescribe the reproduction cost new less depreciation formula."

Had Congress intended to impose upon the Federal Power Commission the "mischievous" doctrine of *Smyth v. Ames*, 169 U. S. 466, as developed into the doctrine of "present value," see *West v. Chesapeake and Potomac Telephone Company*, 295 U. S. 662 (1935) (Mr. Justice Roberts), as a matter of statutory requirement, the Congress surely would have at least used language such as it did use in Section 15a added to the Interstate Commerce Act by the Transportation Act, 1920, which had been held apt to that purpose. *St. Louis and O'Fallon Railroad Company v. United States*, 279 U. S. 461, 478 (1929) (Mr.

Justice McReynolds) (Brandeis, Holmes, and Stone, JJ., dissenting).

Neither in the express words of the statute nor in its legislative history is there any support for the conclusion of the court below that the Natural Gas Act impliedly requires that the lowest just and reasonable rate which the Commission may fix is one which yields a reasonable return upon the "present value" of the physical property.

2. Under the Natural Gas Act, the selection of an appropriate rate base is a matter of sound discretion for the Federal Power Commission.

In *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575 (1942), Justices Black, Douglas and Murphy, concurring, said at page 606:

"Yet it is important to note, as we have indicated, that Congress has merely provided in § 5 of the Natural Gas Act that the rates fixed by the Commission shall be 'just and reasonable.' It has provided no standard beyond that. Congress, to be sure, has provided for judicial review. But § 19(b) states that the 'finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive.' In view of these provisions, we do not think it is permissible for the courts to concern themselves with any issues as to the economic merits of a rate base. The Commission has a broad area of discretion for selection of an appropriate rate base. * * *

The Natural Gas Act legislatively reflects the doctrine of administrative discretion urged by Mr. Justice Frankfurter, concurring, in *Driscoll v. Edison Light and Power Company*, 307 U. S. 104, 122 (1939), when he said:

"* * * The determination of utility rates—what may fairly be exacted from the public and what is adequate to enlist enterprise—does not present questions of an essentially legal nature in the sense that legal education and lawyers' learning afford peculiar competence for their adjustment. These are matters for the applica-

tion of whatever knowledge economics and finance may bring to the practicalities of business enterprise. The only relevant function of law in dealing with this intersection of government and enterprise is to secure observance of those procedural safeguards in the exercise of legislative powers which are the historic foundations of due process."

In the case at bar, Dobie, Circuit Judge, dissenting below, said (IV R. 205):

"A careful study of the Natural Gas Act (particularly the precise wording of Section 6) convinces me that Congress intended to give to the Federal Power Commission a wider latitude and a more extended discretion than had been given to any other federal board or commission under any previous statute in the field of rate making."

A mere standard of reasonableness, without the express requirement of a fair return on fair value, delegates to the Commission only a mediating administrative discretion, see *Freund, Administrative Powers over Persons and Property* (1928) p. 84; and in the Natural Gas Act, the discretion of the Commission is not even qualified by directing the consideration of specified factors.

The function of a rate base is to shed light upon the question of how much a utility will be allowed to earn. See *Group of Institutional Investors v. Chicago Railroad*, 318 U. S. 523, 540 (1943) (Mr. Justice Douglas).

Where the statute specifically authorizes the Commission to fix the lowest reasonable rate, as does the Act here involved (Natural Gas Act Sec. 5(a), *supra*, p. 4; *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 583 (Mr. Chief Justice Stone)), the Commission is at liberty to seek the lowest reasonable measure of a rate base as the limit below which the return can not go within the contemplation of reasonable men. Cf. Beutel, *Valuation as a Requirement of Due Process*, 43 Harvard L. R. 1249, 1253, note 14.

It is therefore respectfully submitted that under the Natural Gas Act, the selection of an appropriate rate base is a matter of sound discretion for the Commission. Cf. *Gray v. Powell*, 314 U. S. 402 (1941) (Mr. Justice Reed); *I. C. C. v. Illinois Central*, 215 U. S. 452, 477-478 (1910) (Mr. Justice White); and see *Brown, Fact and Law in Judicial Review*, 56, Harvard Law Review 899, 921-926 (1943).

3. The Commission's selection of a rate base determined exclusively upon the basis of "prudent investment" measured by actual legitimate cost less the depreciation therein was a reasonable exercise of discretion.

Actual legitimate cost less the depreciation therein is a recognized measure of prudent investment. 74th Congress 1st Sess. Senate Report No. 621, p. 52, Section 208 (May 13, 1935). *Re Canadian River Gas Company*, 43 P. U. R. (N. S.) 205 (F. P. C.) (1942); *Detroit v. Panhandle Eastern Pipe Line Company*, 45 P. U. R. (N. S.) 203 (F. P. C.) (1942); *Re Chicago District Electric Generating Corporation*, 39 P. U. R. (N. S.) 263 (F. P. C.) (1941); *Re Interstate Natural Gas Company* (F. P. C.) 48 P. U. R. (N. S.) 267 (1943); *Bonbright, Valuation of Property*, Vol. II, p. 1139.

Prudent investment has long been considered a reasonable measure of a rate base.

In *Boston and Worcester Railroad Corp. v. Western Railroad Corp.*, 80 Mass. 253, 260 (1859) (Merrick, J.), the Supreme Judicial Court of Massachusetts said:

" * * * It would without doubt be reasonable that the proprietors of a railroad which had been judiciously located and prudently constructed and afterwards properly managed, should annually receive an aggregate sum for all the services of every kind performed by them, at least equal to legal interest upon the amount of their investment, after payment of all current expenses and charges necessarily incurred in preserving their road and its appendages from waste and

depreciation. It is easy to state, and to see the justice and equity of this general proposition."

In *Southwestern Bell Telephone Company v. Public Service Commission of Missouri*, 262 U. S. 276, Mr. Justice Brandeis, with whom Mr. Justice Holmes joined, concurring, said at pages 306-307:

"The adoption of the amount prudently invested as the rate base and the amount of the capital charge as the measure of the rate of return would give definiteness to these two factors involved in rate controversies which are now shifting and treacherous, and which render the proceedings peculiarly burdensome and largely futile. Such measures offer a basis for decision which is certain and stable. The rate base would be ascertained as a fact, not determined as matter of opinion. It would not fluctuate with the market price of labor, or materials, or money. It would not change with hard times or shifting populations. It would not be distorted by the fickle and varying judgments of appraisers, commissions, or courts. It would, when once made in respect to any utility, be fixed, for all time, subject only to increases to represent additions to plant, after allowance for the depreciation included in the annual operating charges. The wild uncertainties of the present method of fixing the rate base under the so-called rule of *Smyth v. Ames* would be avoided; and likewise the fluctuations which introduce into the enterprise unnecessary elements of speculation, create useless expense, and impose upon the public a heavy, unnecessary burden."

On September 22, 1932, Governor Franklin D. Roosevelt said in an address on the subject of power control, delivered at Portland, Oregon, and broadcast to the nation (I Public Papers and Addresses of Franklin D. Roosevelt 727):

"I seek to protect both the consumer and the investor. To that end I propose and advocate now, as I have proposed and advocated heretofore, the following remedies on the part of the government for the

regulation and control of public utilities engaged in the power business and companies and corporations relating thereto:

“‘7. Abolishing by law the reproduction cost theory for rate making and establishing in place of (it) the actual money prudent investment principle as the basis of rate-making.’”

In *Federal Power Commission v. Natural Gas Pipeline Company of America*, 315 U. S. 575, Justices Black, Douglas and Murphy, concurring, said at pages 606-607:

“* * * The requirements of ‘just and reasonable’ embrace, among other factors, two phases of the public interest: (1) the investor interest; (2) the consumer interest. The investor interest is adequately served if the utility is allowed the opportunity to earn the cost of the service. That cost has been defined by Mr. Justice Brandeis as follows: ‘Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor; the allowance for risk incurred; and enough more to attract capital.’ *Southwestern Bell Telephone Co. v. Public Service Commission*, *supra*, 262 U. S. at p. 291. Irrespective of what the return may be on ‘fair value,’ if the rate permits the company to operate successfully and to attract capital all questions as to ‘just and reasonable’ are at an end so far as the investor interest is concerned. * * *”

In the *Matter of Minnesota Power and Light Company*, Docket No. IT 5769, decided March 12, 1942, approximately two months before the decision in the instant case, the Federal Power Commission said:

“Reclassification and original cost studies are an essential aid to prosecution of the war effort in that they provide a sound basis for the most effective control of the prices of utility services entering into practically every important essential war activity as well as into the general cost of living. The availability of such regulation as a means of warding off the dangers

of inflation in this field apparently led the Congress specifically to exempt the control of public utility prices from the provisions of the Emergency Price Control Act of 1942."

In the instant case, Dobie, Circuit Judge, dissenting below, said (IV R. 203-204):

"The Commission, in arriving at the proper rate-base, frankly and openly adopted the Prudent Investment Theory and paid no attention to the present value of the properties of Hope. Mr. Justice Brandeis, in his classic concurring opinion (Mr. Justice Holmes joined in the opinion) in *State of Missouri, ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U. S. 276, has set forth, with his customary incisive clarity, the Prudent Investment Theory, together with the reasons for his belief in that theory. To my mind, the arguments he therein advances have never been convincingly refuted."

The Commission's selection of a rate base determined exclusively upon the basis of "prudent investment" measured by actual legitimate cost less the depreciation therein was a reasonable exercise of discretion. See also *Driscoll v. Edison Light and Power Company*, 307 U. S. 104, 122-123 (1939) (Mr. Justice Frankfurter concurring); *McCart v. Indianapolis Water Company*, 302 U. S. 419, 441 (1938) (Mr. Justice Black dissenting).

It is respectfully submitted that under the Natural Gas Act, as Justices Black, Douglas and Murphy, concurring, tersely stated in *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 606 (1942):

"As we read the opinion of the Court, the Commission is now freed from the compulsion of admitting evidence on reproduction cost or of giving any weight to that element of 'fair value.' The Commission may now adopt, if it chooses, prudent investment as a rate base—the base long advocated by Mr. Justice Brandeis. And for the reasons stated by Mr. Justice Brandeis in

the *Southwestern Bell Telephone* case, there could be no constitutional objection if the Commission adhered to that formula and rejected all others."

B. The Court of Appeals erred in holding that the Commission's findings of actual legitimate cost, the depreciation therein, the annual allowance for depreciation, and the dry hole as an operating expense of 1941, were not conclusive upon the court, since each of said findings has a rational basis and is supported by substantial evidence.

In *American Gas and Electric Company v. Securities and Exchange Commission*, 134 F. (2d) 633, 641 (1943) (Rutledge, Associate Justice) (now Mr. Justice Rutledge); cert. den. 63 S. Ct. 1318, 87 L. Ed. 1165 (June 1, 1943), the court said in construing the Public Utility Holding Company Act of 1935:¹

"* * * The judicial function is exhausted when there is found a rational basis for the conclusions of the Commission after a fair and adequate hearing. (*Rochester Telephone Corp. v. United States*, 1939, 307 U. S. 125, 146, 59 S. Ct. 754, 83 L. Ed. 1147; *Gray v. Powell*, 1941, 314 U. S. 402, 411, 62 S. Ct. 326, 86 L. Ed. 301; *Public Service Corp. of New Jersey v. Securities and Exchange Commission*, 3 Cir., 1942, 129 F. 2d 899, 903.) Although the initial burden is on petitioner to prove to the Commission that its management and policies are not subject to Bond and Share's 'controlling influence,' the Commission's function is to make an adequate and fair appraisal of the weight and credibility of the evidence. (*Detroit Edison Co. v. Securities and Exchange Commission*, 6 Cir., 1941, 119 F. 2d 730, 736; *Pacific Gas & Electric Co. v. Securities and Exchange Commission*, 9 Cir., 1942, 127 F. 2d 378, 382; *Public Service Corp. of New Jersey v. Securities*

¹ Sec. 24(a) 15 U. S. C. Sec. 79x of the Public Utility Holding Company Act of 1935. Like Sec. 19(b) of the Natural Gas Act, provides that "the finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive."

and Exchange Commission, 3 Cir., 1942, 129 F. 2d 899, 902. The Commission, like other expert agencies dealing with specialized fields, has the function of appraising conflicting and circumstantial evidence and the weight and credibility of testimony. *National Labor Relations Board v. Link-Belt Co.*, 1941, 311 U. S. 584, 597, 61 S. Ct. 358, 85 L. Ed. 368; *Rochester Telephone Corp. v. United States*, 1939, 307 U. S. 125, 146, 59 S. Ct. 754, 83 L. Ed. 1147.) ”

1. **The Commission's finding of actual legitimate cost has a rational basis and is supported by substantial evidence.**

It was not irrational for the Commission to adopt after extensive investigation substantially the investment shown by the respondent's books as the actual investment which the owner had made to establish the business, and to reject the respondent's attempt to write up the investment by about \$17,000,000 which the evidence showed had already been recouped from the public as a day to day cost of operating the business.

The Commission reasonably adopted the investment substantially as shown by the respondent's books.

The books of a corporation are ordinarily prima facie evidence of the investment which the owners have made. This rule arises from the fact that the investment spread upon the books of a corporation, particularly in the public utility field, is not put there merely as the hobby of an eccentric. The rule arises from the known fact that the books of a corporation, even a subsidiary corporation like the Hope Company, show the investment as a basis of day to day decisions of management, as a basis of reports to tax authorities, as a basis of reports to regulatory commissions, and as a record for the information of the public and its government generally. (I R. 260, 253; II R. 173-175.) The books of a public utility corporation are ordinarily prima facie evidence of the facts set forth therein. *Newton v. Consolidated Gas Company*, 258 U. S. 165, 176 (1922) (Mr. Justice McReynolds).

The extensive investigation of the books and supporting vouchers of the respondent by the Commission's staff confirmed the rule that the respondent's books show prima facie the investment the owner has made in establishing the business. From October of 1938 to February of 1941, the Federal Power Commission's staff conducted an extensive investigation of the books, records, and vouchers of the respondent, after which it concluded that the books correctly show the investment the owner has made to establish the business, except for one accounting error amounting to approximately \$1,300,000, which the Commission corrected. (III R. 25-39; I R. 35.) The Commission's conclusion that the investment in the respondent's property devoted to interstate business is substantially that shown by the books (I R. 23) is not merely sustained by the prima facie evidence rule attaching to book figures of a corporation such as respondent; but is also supported by substantial testimony.

The Commission rationally rejected the respondent's attempt to write up the investment by about \$17,000,000 which the evidence showed was a cost of the day to day operation of the business which had long since been recouped from the public.

The respondent complains that the Commission did not add to the investment substantially as shown by the books a further sum of approximately \$17,000,000 for well drilling expenses prior to 1923, overheads, and miscellaneous items, which the respondent had always hitherto treated as a cost of operating the business. It appears that the Federal Power Commission reasonably rejected this claim and that its conclusion is supported by substantial evidence.

The respondent's management has always treated the items of well drilling expenses prior to 1923, overheads, and other miscellaneous items as day to day costs of operating the business, and not as an investment which the

owner had made in establishing the business. Mr. Joseph C. Chisler, Vice President, Treasurer, director and chief accounting officer of the Hope company, and a responsible member of the management, testified that the items aggregating \$17,000,000 previously charged to operating expenses and now sought to be included in the investment, were charged to operating expense accounts either pursuant to a code of accounts or in the exercise of managerial discretion. (II R. 172-173.) Mr. Chisler said that the respondent had an option in respect to the treatment of well construction costs and made an election and charged such costs to operating expense. (II R. 173.) He stated that the accounting officers of the respondent had all been competent men. (II R. 173.) Chisler also testified that the charging of well construction costs to operating expenses from the beginning of operations until 1923 was in accordance with accounting principles followed at that time and which had been followed by oil companies. (II R. 174.) He stated that under federal income tax regulations, the respondent could also elect to treat well construction costs either as operating expense or capital, and that it had elected to treat them as operating expense. (II R. 176.) It is a matter of public record that in 1921 the respondent claimed and the West Virginia Commission held that well drilling expenditures constituted at that time and in that stage of the industry a cost of operating the business and not an investment which the owner had made for the purpose of establishing the business. *Re Hope Natural Gas Company*, P. U. R. 1921 E. 418, 439-440. In fact, down to the very day of the commencement of the present controversy, the responsible managerial and accounting officers of the Hope Natural Gas Company had written these early well drilling costs, overheads, and other miscellaneous items off as operating expense, and it is difficult to understand by what legerdemain these costs of operation have suddenly been transmuted into an owner's investment.

The Commission found that the expensed items had been recouped through revenues from Hope's customers (I R. 28) and this finding is supported by substantial evidence. (I R. 34; III R. 13-14, years 1898-1923.)

The Commission's chief accountant testified that it would be unjust and inequitable to the public to permit this gas company, which has once recouped these operating costs through revenue from rates, now to include those same expenditures in the investment so that the customers must again pay these costs to the utility in the guise of a return of the investment through depreciation and depletion allowances in addition to paying a return upon these past operating expenses for years to come. Mr. Charles W. Smith, Chief of the Bureau of Accounts, Finance and Rates of the Federal Power Commission, and a nationally known authority on public utility accounting (I R. 225-227), testified that it would be unjust and inequitable to the public to permit items previously charged to operating expenses under the allowable discretion of management and without accounting error to be later included in the base upon which customers are required to pay a return and depletion and depreciation allowances. Mr. Smith said (I R. 305-306):

"Q. If the company were permitted to capitalize retroactively items which it had formerly expensed, in a rate case, would not multiple charges against the consumers result?

(Objection overruled.)

The Witness: It would be purely a question of fact. If they are allowed as expenses and then put in plant and allowed again, of course, there is duplication."

The decided cases hold that once the management without accounting error decides to treat an item as a cost of operation, it remains a cost of operating the business and not an investment that the owners have made for the purpose of establishing the business in spite of later changes in

accounting practice or management election, which can operate only for the future. *Peoples Gas Light and Coke Company v. Slattery*, 373 Ill. 31, 51, 25 N. E. (2d) 482, 493, 31 P. U. R. (N. S.) 193, 207; App. Dismissed 309 U. S. 634; *Los Angeles Gas and Electric Corporation v. Railroad Commission of California*, 58 F. (2d) 256, 260, P. U. R. 1932 C, 397, 404, aff'd. 289 U. S. 287; *Natural Gas Company of West Virginia v. Public Service Commission*, 95 W. Va. 557, 570-572, 121 S. E. 716, 720, P. U. R. 1924 D, 346, 357-361; and see *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 589 (1942).

On behalf of the gas consumers in Cleveland who would ultimately be required to pay higher rates to the affiliated East Ohio Gas Company for the unjust enrichment of the respondent Hope Natural Gas Company if the Federal Power Commission had held otherwise, petitioner respectfully submits that the Federal Power Commission acted properly in rejecting the respondent's attempt to inflate for rate case purposes the investment which its management had long recognized and spread upon its books as the actual investment.

The presumption, supported by testimony of both the respondent's management and the public accounting authorities establishing that the respondent's books substantially show the investment made by the owner, was not overthrown by the testimony of an engineer who undertook to inflate the utility's investment under the guise of re-accounting as capital for items charged to day to day cost of operation in the past. The respondent presented no independent accounting witness to testify that these 17 millions of dollars of intangible well drilling expenditures, overheads, and miscellaneous items are an investment of the owner of the property. Instead, the respondent presented in support of its rate case claim an engineer, who devoted 400 volumes of working papers to the alchemy of transmuting what the management had always treated as

operating expenses into investment for rate case purposes. (Antonelli, Tr. 1425.) But, being an honest man, Mr. Antonelli was finally forced to admit under cross examination by Mr. Slaff of Federal Power Commission counsel that it is improper to capitalize items which have previously been expensed by the respondent, exercising its discretion under a controlling system of accounts. He said (IV R. 326-327):

"By Mr. Slaff:

Q. I see. Then I understand your present testimony to mean that you consider it improper to capitalize items which have previously been expensed by the company exercising its discretion under a controlling system of accounts, is that correct? (Objection overruled.)

. . .

A. Yes, sir.

By Mr. Slaff:

Q. And that applies, of course, not only to the specific account that we were discussing, but throughout?

Mr. Milde: Same objection.

By Mr. Slaff:

Q. I mean, you weren't confining that to a specific account, were you?

Mr. Milde: Same objection.

Trial Examiner: Objection overruled.

A. No, sir."

With that admission by the respondent's witness, the respondent's case for inflating its investment by \$17,000,000 of items previously recouped from the public as costs of day to day operation of the business collapsed.

Dobie, Circuit Judge, dissenting below, said on this branch of the case (IV R. 205, 206-207):

"Further, I think that the methods adopted by the Commission under the Prudent Investment Theory, in

arriving at a rate-base in the instant case, were neither fanciful nor arbitrary. It seems to me, too, that there was substantial evidence to support the opposite findings of the Commission.

The Commission refused to allow as capital the amount of drilling cost which Hope had in the past charged to operating expenses. The Commission found (and I think this finding is supported by the evidence) that these costs had been considered by Hope in fixing its rates in previous years and that these costs had already been paid by the consumers. On this ground, the Commission declined to include these costs in arriving at the rate-base.

It was the practice of Hope, prior to 1923, to charge well-drilling costs to operating expenses rather than to capital account. In so doing, Hope seems to have followed the then general procedure of the natural gas industry. It changed this practice under a requirement of the Public Service Commission of West Virginia. The present system of accounting prescribed by the Federal Power Commission also follows the West Virginia practice. It is my considered opinion that the present procedure is the proper one.

It is to be noted that this is not a mere mathematical error in book-keeping, which of course, should be corrected. It is rather an accounting policy. It does not seem to me to be vital whether the decision of the Commission here is based upon technical estoppel, equity or fair dealing. And once more, I think the Commission should be here sustained. Under its present claim, Hope seeks to impeach its books, which were competently kept for a long period of years under the older method. And Hope itself, in a previous rate case before the Public Service Commission of West Virginia, claimed these well-drilling costs as operating expenses, its contention was allowed, and its rates were fixed accordingly.

The holding of the Commission here is sustained by the great weight of authority. In the Commission's brief, these authorities are set out at great length, and include decisions of federal courts, decisions of state

courts, and decisions of State Utility Commissions. Quite striking here, I think, is an extract from the majority opinion in the recent *Natural Pipe Line* case (315 U. S. at pages 590, 591):

‘Here the companies, though unregulated, always treated their entire original investment, together with subsequent additions, as capital on which profit was to be earned. They charged the out-of-pocket cost of maintenance of plant, whether used to capacity or not, as operating expenses deductible from earnings before arriving at net profits. *They have thus treated the items now sought to be capitalized in the rate base as operating expenses to be compensated from earnings, as in the case of regulated companies. . . . We cannot say that the Commission has deprived the companies of their property by refusing to permit them to earn for the future a fair return and amortization on the costs of maintenance of initial excess capacity—costs which the companies fail to show have not already been recouped from earnings before computing the substantial “net profits” earned during the first seven years.*’ (Italics ours.)”

It is respectfully submitted that the Commission's findings of actual legitimate cost has a rational basis and is supported by substantial evidence.

2. **The Commission's finding as to the depreciation in the actual legitimate cost has a rational basis and is supported by substantial evidence.**

There is no inconsistency between the Commission's method of determining the investment and its method of determining the depreciation in the investment. The Commission adopted substantially the book investment, because it found after extensive investigation, that the books stated the investment without serious accounting error. It rejected the book figures for depreciation in the investment because the Commission's investigation and the testimony of the respondent's witnesses showed that

the book reserve for depreciation was shot through with error, having been built up by charging to operating expenses over the years excessive amounts of annual depreciation. (III R. 176; II R. 399; I R. 40.) Were that not so, as it is, the respondent could hardly be heard to complain, for the Commission's method of determining depreciation in the investment results in depreciating the original investment about \$25,000,000 less than if the respondent's own book depreciation accruals had been adopted as the measure of the depreciation in the investment. (I R. 46; I R. 86.)

The Commission's method was apt for the purpose of determining the depreciation in the investment.

The Commission's method for determining depreciation and depletion in the investment pursuant to the Natural Gas Act, Section 6(a) as of December 31, 1940 is explained as follows in the Commission's Opinion (I R. 45):

"The required depletion and depreciation reserve, as we have determined it upon the record, is the best evidence of the measure of actual existing depletion and depreciation, and it will be deducted from the actual legitimate cost of the Company's property for rate-making. The reserve requirement on any selected date is the total of the annual provisions for depletion and depreciation less the actual retirements of property. The method used here determines the amount required annually to reimburse the Company for property consumed in service, and it results in a correlation of the annual expense and the accumulated reserve. The method is just and consistent for each operating period because the costs utilized are matched with the revenues produced by the property in service."

The economic service life method is a recognized method of determining depreciation in the investment and the annual allowance for depreciation or return of the investment.

The method used by the Commission in this case produces substantially the same result as the method which the Commission used and this Court approved in *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 593-595 (1942). In the *Natural Gas Pipeline Company* case, the Commission employed the sinking fund method of providing for annual amortization or depreciation allowances, and used as the interest attributable to the fund in the calculation the same interest rate as the rate of return. The use of the sinking fund formula with the same rate of interest as the rate of return has substantially the same effect as a straight-line annual allowance coupled with a rate base deduction for depreciation equivalent to the ratio of the expired service life of the property to the total service life of the property. See *Public Utilities Commission of District of Columbia v. Capital Traction Company*, 17 F. (2d) 673, 676 (District of Columbia Court of Appeals); *Re Duluth Street Railway Company*, P. U. R. 1923 D, 705, 737-738 (Wisconsin Commission).

For example, in the *Natural Gas Pipeline* case, the expired service life was approximately one-third of the assumed overall service life. The use of the sinking fund formula by the Federal Power Commission in that case was equivalent to the use of a straight line annual allowance for depreciation in operating expenses coupled with deduction of a depreciation of one-third of the amount of the original investment in the property. Therefore, the use of the sinking fund formula by the Commission in the *Natural Gas Pipeline Company* case was similar to what the Commission did in the instant case, where the Commission made a straight line annual allowance in operating expenses, while at the same time deducting from the original investment depreciation in proportion to the relation that the expired service life bears to the total service life, or about 43 per cent. The decision of this Court affirming

the Federal Power Commission's decision in the *Natural Gas Pipeline* case is therefore a square precedent for affirmance in the instant case.

Both methods harmonize the deduction for depreciation in the investment, express or implied, with the annual allowance for depreciation in the investment. The fact that the Commission used the sinking fund formula instead of the straight line method in the *Natural Gas Pipeline* case should not obscure the fact that this Court's affirmance in the *Natural Gas Pipeline* case applies with equal force to the deduction of the reserve requirement from the original investment where, as here, an annual allowance based on the straight line method is made. This Court said in the *Natural Gas Pipeline* case that "The companies are not deprived of property by a requirement that they credit in the amortization account so much of the earnings received during the prior period as are appropriately allocable to it for amortization." (315 U. S. 575, 595.) So here, the respondent is not deprived of property by the finding of the Commission that a proper depreciation in the investment is that proportion of the investment which the expired service life bears to the total service life.

The Commission's finding of depreciation was supported by substantial evidence.

In arriving at its determination of the depreciation in the investment in the instant case, the Commission properly relied on its engineers to determine the ultimate composite service life of the investment. (III R. 151.) And it properly relied upon its accountants to determine how much of the ultimate service life of the investment had already been used up in the public service. (III R. 175.)

The lower court erroneously stated that in determining the actual existing or accrued depletion and depreciation the Commission failed to take into account "the present condition of the property." (Majority Opinion, IV R. 189.) In making these determinations the Commission was in

fact guided by a study conducted by a qualified staff engineer, who made a field inspection of the Company's physical properties to aid in the determination of service lives. (I R. 42; III R. 157-158.)

The Commission's straight-line service-life method of determining depreciation in the investment represents its judgment as an experienced administrative body as to the consumption of capital, on a cost basis, according to the method which spreads the loss over the respective service periods. See *Lindheimer v. Illinois Bell Telephone Company*, 292 U. S. 151, 169 (1934).

The majority below complained that the net investment in certain accounts found by the Commission is less than gross salvage value. (IV R. 189.)

In the first place, it is wholly improper to compare the net investment found by the Commission for these accounts with the alleged gross salvage value. Any proper comparison should be with the net salvage value. The negative salvage, i.e., the cost of removal or abandonment and delivery for sale of certain items of utility property may be and sometimes is greater than the gross salvage value, or what the item could be sold for. The respondent's witness Rhodes himself used net salvage value in arriving at his estimated claimed net value of the property. (II R. 422.) The unfairness and gross impropriety of comparing the Commission's net investment of well equipment, for example, with the gross salvage value of well equipment is emphasized by the fact that the respondent's witness Rhodes estimated a lower net value for well equipment than his gross salvage value of 65 per cent, to wit 56 per cent. (I R. 369.)

Finally, Hope's claimed "gross salvage" percentages do not represent the ultimate salvage from retirements of equipment at the end of its useful life, but are inflated by the inclusion of so-called warehouse recoveries which are transfers of reusable equipment from plant to the ware-

house at full book cost. Respondent's witness Rhodes recognized this fact and, in determining the gross salvage of gas well equipment, made an adjustment purporting to correct for it, although he merely estimated, from some inspection, that re-useable gas well equipment returned to the warehouse had depreciated 12 per cent and, instead of eliminating from the calculation the equipment that was to be reused, he merely made a minor reduction. (I R. 469-470.) The effect of the inclusion of re-useable equipment in the calculation of per cent salvage is demonstrated by a comparison of the gross salvage from gas well equipment that could no longer be used or was abandoned of about 33 per cent (11 per cent salvage from 34 per cent of equipment, I R. 469-470) with the 65 per cent determined by including re-useable equipment, even though the minor adjustment for observed depreciation in the re-useable equipment had been made. In comparing the Commission's net investment in field line and compressor station equipment with the alleged gross salvage figures, the respondent makes no adjustment even for the depreciated condition of re-useable equipment. (I R. 470-471.)

The respondent's attempted comparison of the Commission's *net* investment in well equipment, field line pipe, and compressor station equipment with the claimed *gross* salvage value of these items, which apparently impressed the majority below, is wholly meaningless.

It is respectfully submitted that the method used by the Commission was apt for the purpose of determining the depreciation in the investment, and that the Commission's finding of depreciation was supported by substantial evidence.

After carefully examining the record, Dobie, Circuit Judge, dissenting in the court below, said on this branch of the case (IV R. 205):

"In computing depreciation and depletion, the Commission employed the Economic Life Service Method.

This formula has long been known to, and has been frequently applied by, economists and accountants. It seems to have been often used in connection with depreciation under the federal income tax. I cannot find in this formula any active germs of constitutional invalidity, as it is applied to the instant case.

"The Commission based its determination of existing depletion and depreciation upon actual legitimate cost of the properties of Hope. An apparently competent engineer inspected this property to obtain information that would serve as a guide for estimating the property's service life and the amount of money required annually to reimburse Hope for so much of this property as might be consumed in rendering service to the public.

"Incidentally, the amount deducted by the Commission fell short by many millions of dollars of the amount accrued and set up by Hope for depreciation and depletion. In his partially dissenting opinion Commissioner Scott expressed the view that the Commission had been, in fixing the amount for depreciation and depletion, far too lenient with Hope.

"Again I feel that there was substantial evidence to sustain the Commission's findings under a formula which was neither unrealistic nor capricious."

It is respectfully submitted that the Commission's finding as to the depreciation in the actual legitimate cost has a rational basis and is supported by substantial evidence.

3. The Commission's finding as to the annual allowance for depreciation has a rational basis and is supported by substantial evidence.

Here the question is whether in a wasting asset business annual allowances for depreciation and depletion may be based upon investment rather than upon reproduction cost. That question has quite recently been decided in favor of the investment base as against the reproduction cost

base by this Court. *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 593 (1942). In a wasting asset business, any scheme of depreciation allowance which will restore the capital investment by the end of its useful life involves no injustice. The Commission's annual allowance for depreciation restores from current earnings the amount of service capacity of the investment consumed in each year, which is reasonable. See *Lindheimer v. Illinois Bell Telephone Company*, 292 U. S. 151, 167. Had the Commission allowed depreciation and depletion on the theoretical reproduction cost of well drilling expenses, overheads and other intangible items previously recovered as operational costs, items in which the owners have made no investment, as the court below held it should have done, the depreciation and depletion allowance would not be the computation of a proper expense, but instead the allowance of additional profit over and above a fair return.

The respondent complained that "by omitting 2600 wells and thousands of other property items actually in service from its 'adjusted book cost' the Commission treats them as nonexistent or in zero per cent condition" and makes no allowance therefor by way of annual depletion. (IV R. 25.) Of course, the Commission did not omit 2600 wells from the investment. Its determination of the investment includes the investment in materials in all the 3300 wells of the respondent. The investment does not include well drilling expenses for certain of the wells because the respondent prior to 1923 elected to treat drilling expenses as costs of operating the business and recovered those costs currently from the public through revenues. The Commission properly did not allow any depletion on the drilling expenses for these wells, because the owner has made no investment in these drilling expenses for the purpose of establishing the business.

It is respectfully submitted that the Commission's finding as to the annual allowance for depreciation has a rational basis and is supported by substantial evidence.

4. **The Commission's finding that the deep test dry hole is an operating expense in 1941, when it was booked, has a rational basis and is supported by substantial evidence, and even if there were error on the part of the Commission in not treating the said dry hole as an operating expense of 1940, the error is harmless.**

The lower court approved the respondent's claim for an increase in the Commission's allowance for exploration and development costs upon the ground that it should be allowed \$165,000 more for dry hole expense than the books showed it spent in 1940. (IV R. 198.) As a matter of fact, the Commission in fixing future rates allowed the respondent \$192,000 more for exploration and development expense than the books showed it actually spent in 1940 without making any allowance for the known upward trend in gross sales and revenues. (I R. 70.) But laying to one side the fact that the respondent's claim for dry hole expense is academic so far as the reasonableness of the Commission's rate order is concerned, the lower court's suggestion that dry hole expense booked in 1941 should be treated as a 1940 expense because the money was spent in that year is wholly impractical and unreasonable. (IV R. 198.) Upon the lower court's theory, many expense items booked in 1940 would have to be treated as expenses of 1939 when the money was spent, and many expenses booked in 1939 would have to be treated as operating expenses of 1938 when the money was spent, and this would force a complete reaccounting of the book operating expenses back through the years with no proof that such a reaccounting would produce overall any substantial change in the allowable operating expenses for 1940. This the Commission was not required to do. The Commission's

finding as to dry hole expense has a rational basis and is supported by substantial evidence.

It is respectfully submitted that the Court of Appeals erred in holding that the Commission's findings of actual legitimate cost, the depreciation therein, the annual allowance for depreciation, and the dry hole as an operating expense of 1941, were not conclusive upon the court since each of said findings has a rational basis and is supported by substantial evidence.

Since the Court of Appeals erred in holding that for rate-making purposes under the Natural Gas Act, the Commission is not authorized to use a rate base determined exclusively upon the basis of "prudent investment" measured by actual legitimate cost less depreciation, but that it must use a rate base which reflects estimates of the extent and effect of post investment fluctuations in labor and material prices, and since the Court of Appeals erred in holding that the Commission's findings of actual legitimate cost, the depreciation therein, the annual allowance for depreciation, and the dry hole as an operating expense of 1941, were not conclusive upon the court since each of said findings has a rational basis and is supported by substantial evidence, therefore it is respectfully submitted that the Court of Appeals erred in setting aside the Federal Power Commission's "Order Reducing Rates," for the reason that said order is authorized by the Natural Gas Act, and is based upon findings which have a rational basis and are supported by substantial evidence.

III.

EVEN IF THERE WERE A CONSTITUTIONAL QUESTION INVOLVED, AS THERE IS NOT, THE COURT OF APPEALS FURTHER ERRED IN SETTING ASIDE THE FEDERAL POWER COMMISSION'S "ORDER REDUCING RATES" FOR THE REASON THAT IN THE ABSENCE OF AN EXERCISE OF THE POWER OF EMINENT DOMAIN OR OTHER DIRECT APPROPRIATION OF PROPERTY FOR THE USE OF THE UNITED STATES GOVERNMENT, RESPONDENT WAS NOT ENTITLED UNDER THE FIFTH AMENDMENT TO ANYTHING MORE THAN DUE PROCESS OF LAW.

The Commission's "Order Reducing Rates" was made within the ambit of the Commission's statutory authority. A fair hearing was given. Proper findings were made. Nothing arbitrary was done by the Commission. Respondent was accorded due process of law.

Upon these facts, the court below plainly erred in holding that the Commission's "Order Reducing Rates" results in confiscation of respondent's property contrary to the Fifth Amendment because it does not purport to give respondent a return upon the "present value" of respondent's physical property, in addition to due process of law.

The clause of the Fifth Amendment which forbids a taking of private property for public use without just compensation applies where the Federal Government attempts to exercise the power of eminent domain or otherwise makes a direct appropriation of private property for the use of the Government, *Pumpelly v. Green Bay Canal Company*, 13 Wall. 166 (1871); *United States v. Lynch*, 188 U. S. 444 (1902); *United States v. Cress*, 243 U. S. 316 (1916); *Jacobs v. United States*, 290 U. S. 13 (1933), but does not apply where, as here, there is a mere regulation of the use of the property under the Commerce clause or other granted power for the protection and promotion of the welfare of the economy. *Legal Tender Cases*, 12 Wall. 457, 551 (1872) (Mr. Justice Strong); *Morrisdale Coal Co.*

v. United States, 259 U. S. 188, 190 (1922) (Mr. Justice Holmes); see *Henderson v. Bryan*, 46 F. Supp. 682, 685 (S. D. Cal.) (1942) (Harrison, J.).

The clause of the Fifth Amendment which forbids deprivation of property of any person without due process of law does not forbid all deprivation of property, which would destroy the power to regulate, but only forbids a deprivation of property without due process of law. *United States v. Darby*, 312 U. S. 100, 125-126 (1941) (Mr. Justice Stone); *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 586 (1942) (Mr. Chief Justice Stone); and see *North American Company v. Securities and Exchange Commission*, 133 F. (2d) 148, 154 (C. C. A. 2) (1943) (Swan, J.); Cf. *Driscoll v. Edison Light and Power Company*, 307 U. S. 104, 122 (1939). (Mr. Justice Frankfurter, concurring.)

Regulation of the rates of a natural gas company under the commerce power is not the same as condemning private property for public use without paying just compensation. If regulation of natural gas rates under the commerce power were to be construed as a taking of private property for public use within the meaning of the Fifth Amendment, there would be an implied contract on the part of the Federal Government to pay to the respondent the value of the property so appropriated for public use. *United States v. Lynah*, 188 U. S. 445, 464-465 (1903); *Henderson v. Bryan*, 46 F. Supp. 682, 685 (D. C. Cal.) (1942). It may be conceded that when the Federal Power Commission's order was made, upon a date several months after Pearl Harbor, the Federal Government had a right, as it still has, to requisition respondent's property, the use of respondent's property, or respondent's product for public use for the war purpose of combating inflation or for any other war purpose. Constitution of the United States, Article I, Sec. 8, cl. 11-16, Article II; Second War Powers Act, 1942 (effective March 27, 1942), Title II, 56 Stat. 177, 50 U. S. C. A. App. Sec. 632; Executive Order No. 9328,

par. 4, 8 F. R. 4681 (April 8, 1943); *Highland v. Russell Car Company*, 279 U. S. 253, 261-262 (1929) (Mr. Justice Butler); see Franklin, War Powers of the President, 17 *Tulane L. R.* 217 (1942). "But a liability in any case is not to be imposed upon a government without clear words." See *Pine Hill Coal Company, Inc. v. United States*, 259 U. S. 191, 196 (1922) (Mr. Justice Holmes). And the clause of the Fifth Amendment which requires just compensation for a taking of private property for public use simply does not apply to a regulation of the use of property under the commerce clause for the general welfare, such as the Natural Gas Act, or an order made pursuant thereto.

In cases involving federal regulations of the use of property under the commerce power, the Fifth Amendment guarantees only due process of law, and does not provide for a return on or of the present or condemnation value of the physical property, in addition to due process of law.

That is what we understand this Court to have meant in *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 586 (Mr. Chief Justice Stone), where the Court said:

"The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances. Once a fair hearing has been given, proper findings made and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end."

And that is what the concurring justices apparently understood the decision of this Court to mean in *Federal*

Power Commission v. Natural Gas Pipeline Company, 315 U. S. 575 (1942), (Justices Black, Douglas and Murphy, concurring, at page 606), when they said:

“As we read the opinion of the Court, the Commission is now freed from the compulsion of admitting evidence on reproduction cost or of giving any weight to that element of ‘fair value.’ The Commission may now adopt, if it chooses, prudent investment as a rate base—the base long advocated by Mr. Justice Brandeis. And for the reasons stated by Mr. Justice Brandeis in the *Southwestern Bell Telephone* case, there could be no constitutional objection if the Commission adhered to that formula and rejected all others.”

It is respectfully submitted that even if there were a constitutional question involved, as there is not, the Court of Appeals further erred in setting aside the Federal Power Commission's “Order Reducing Rates” for the reason that in the absence of an exercise of the power of eminent domain or other direct appropriation of property for the use of the United States Government, respondent was not entitled under the Fifth Amendment to anything more than due process of law.

IV.

THE COURT OF APPEALS ERRED IN HOLDING THAT THE FEDERAL POWER COMMISSION HAS NO JURISDICTION TO DETERMINE THE LAWFUL RATES FOR INTERSTATE SALES OF NATURAL GAS AT WHOLE SALE AFTER THE EFFECTIVE DATE OF THE NATURAL GAS ACT OF 1938 AND PRIOR TO THE ISSUANCE OF A COMMISSION RATE-FIXING ORDER, FOR THE REASON THAT SAID JURISDICTION IS IMPLIED FROM EXPRESSLY GRANTED POWERS, AND IS SUPPORTED BY THE LEGISLATIVE HISTORY OF THE STATUTE.

The Federal Power Commission's ultimate "Findings as to Lawfulness of Past Rates" are (I R. 12-13):

"(23) Cost, conditions and characteristics of service show that the just, reasonable and lawful rates for natural gas sold by Hope Natural Gas Company in interstate commerce to The East Ohio Gas Company for resale for ultimate public consumption were those required to produce compensation in the amount of \$11,528,608 for 1939, \$11,507,185 for 1940, and \$11,910,947 annually since 1940;

"(24) The rates charged and received by the Hope Natural Gas Company for the transportation and sale of natural gas in interstate commerce to The East Ohio Gas Company for resale for ultimate public consumption were unjust, unreasonable, excessive, and therefore unlawful to the extent of \$830,892 during 1939, \$3,219,551 during 1940, and \$2,815,789 on an annual basis since 1940."

In support of its jurisdiction to make these findings, the Commission said in its opinion (I R. 67-69):

"In 1938 the Cities of Cleveland and Akron, Ohio, filed complaints with the Federal Power Commission alleging that the rate which Hope charged East Ohio Gas Company was unjust, unreasonable and unlawful. These complaints were registered before Hope filed its five interstate wholesale rate schedules which are involved in these proceedings. The acceptance of a rate schedule for filing does not mean that the Com-

mission approves it, and does not establish the justness or reasonableness of the rate. *Re Home Gas Co.*, 39 P. U. R. (N. S.) 102, 109. On October 14, 1938, this Commission instituted an investigation of the reasonableness of all of Hope's interstate rates. If it had been possible to adduce the volume of evidence required for the disposition of such a complex matter within a few months, the Commission would have prescribed the reasonable interstate wholesale rates for 1939 and subsequent years. The City of Cleveland raised the issue of the lawfulness of the rate charged by Hope to the East Ohio Gas Company and asked this Commission as an aid to State regulation, to make a separate determination of the reasonable rates since June 30, 1939. Originally the City of Cleveland requested this Commission to find the lawful Hope-East Ohio rates since June 21, 1938, but it now represents that the subject is idle for rates prior to June 30, 1939, because those rates which Cleveland consumers were obligated to pay East Ohio have been settled. The Commission does not have the authority to fix rates for the past and to award reparations. But Congress did empower and instruct the Commission in Section 5(a) of the Natural Gas Act to fix future rates, and as a step in that process we must necessarily consider the reasonableness of past and existing rates. When the issue is raised and the public interest will be served, we consider as a necessary part of that duty the power to examine the entire rate problem involved and to determine what rates were lawful in the past. Also, Section 14(a) of the Act authorizes the Commission to investigate any facts which it finds necessary in order to determine whether Hope has violated any provision of the Natural Gas Act. Furthermore, the Commission has power to perform any act, pursuant to Section 16, which is necessary or appropriate to carry out the provisions of the Act. Under Section 4(a) of the Act any interstate wholesale rate that is not just and reasonable is unlawful. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U. S. Hope's rate collected from East Ohio Gas Company was lawful after June 21, 1938, the effective date of the Act, only to the extent that it was just and reason-

able. The City of Cleveland states that the Ohio Commission is investigating the reasonableness of the East Ohio Gas Company's bonded retail rates in Cleveland for the period since June 30, 1939, and that the lawfulness of Hope's rate is an important factor in the case. Since the enactment of the 1938 Natural Gas Act this Commission has had exclusive jurisdiction to determine the lawfulness of the interstate wholesale rates charged by Hope and other natural gas companies. (Sections 1, 2, 4 and 5(a). See *Missouri v. Kansas Natural Gas Co.*, 265 U. S. 298, 308; *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U. S. 498, 506; *Kentucky Nat. Gas Corp. v. P. S. C.*, 28 F. Supp. 509, 513, aff. 119 Fed. (2d) 417.)

"In response to the request of the City of Cleveland, the Commission will make the appropriate findings of fact as to the lawfulness of the rates charged East Ohio by Hope since June 30, 1939. The Interstate Commerce Commission has furnished precedents for the performance of this public duty. (*W. A. Barrows Porcelain Enamel Co. v. Cushman Motor Delivery Co.*, 11 M. C. C. 365, 366; *Dixie Mercerizing Co. v. ET & WNC Motor Transp. Co.*, 21 M. C. C. 491, 492. See: *United States v. Morgan*, 307 U. S. 183, 313 U. S. 409; *Lima Tel. Co. v. P. U. C.*, 98 O. S. 110, 120 N. E. 330.) Congress intended that this Commission cooperate with State Commissions and municipalities, and the provisions of Sections 5(b) and 17 are special evidence of such intent."

The court below held that the Federal Power Commission has no jurisdiction to determine upon complaint of a municipality and upon its own investigation that a natural gas company has violated Section 4(a) of the Natural Gas Act by charging an unjust, unreasonable and therefore unlawful initial rate, and to determine the lawful rate for a period after the passage of the Natural Gas Act and prior to a Commission order fixing future rates. (IV R. 200-202.)

This raises the question whether the Commission has jurisdiction to determine the *lawful* rates for interstate

sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of an initial Commission rate-fixing order.

This question is of substantial importance to petitioner, the City of Cleveland, because the Federal Power Commission's "Findings as to Lawfulness of Past Rates," if valid, considered apart from the Commission's "Order Reducing Rates," furnish an appropriate basis for refunds to Cleveland consumers of temporary rates collected under bond by respondent's affiliate, The East Ohio Gas Company, in pending proceedings before The Public Utilities Commission of Ohio (*East Ohio Gas Company v. City of Cleveland*, P. U. C. O. Nos. 11,001, 11,218, 11,442), of \$3,600,000 or an average of about \$13 per customer from June 30, 1939 to June 30, 1942.

Conversely, the holding of the Court below that initial filed rates of a natural gas company are the only lawful rates until changed by a future rate-fixing order of the Federal Power Commission, unless reversed by this Court, would become *res judicata* between Cleveland and The East Ohio Gas Company as a privy of Hope, cf. *Sunshine Coal Company v. Adkins*, 310 U. S. 381, 389-391, 401-404 (1940) and in that event, the \$3,600,000 would permanently inure to the benefit of the Standard Oil Company (New Jersey), which is the sole owner of both Hope and East Ohio.

A. The jurisdiction of the Commission to determine LAWFUL rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order is implied from the expressly granted power to determine upon complaint of a municipality and upon the Commission's own investigation, that the act has been violated by charging an unlawful rate and by not charging a lawful rate.

Under Section 4(a) of the Natural Gas Act, it is a violation of the Act to charge an unlawful rate, and it is a

further violation of the Act not to charge a lawful rate. Section 4(a) provides that (15 U. S. C. A. Sec. 717c (a)):

“(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.”

Section 13 of the Natural Gas Act authorizes the filing of complaints by “any State, municipality, or State commission complaining of anything done or omitted to be done in contravention of the provisions of this chapter.” (*Supra*, p. 4.)

Section 14(a) of the Natural Gas Act provides that “the commission may investigate any facts * * * which it may find necessary * * * to determine whether any person has violated * * * any provision of this act * * *” and further provides that “the commission * * * may publish * * * and make available to State commissions and municipalities, information concerning any such matter.” (*Supra*, p. 5.)

Section 16 of the Act provides that “the commission shall have power to perform any and all acts * * * as it may find necessary or appropriate to carry out the provisions of this chapter.” (*Supra*, p. 5.)

In short, it is an express violation of the Act to charge an unjust, unreasonable and unlawful rate and not to charge a just, reasonable and lawful rate. The City of Cleveland was expressly authorized to complain, as it did, that the respondent, Hope Natural Gas Company, had charged an unlawful rate and had not charged a lawful rate in contravention of the provisions of the Act. The Commission was expressly authorized to investigate and to determine whether Hope had violated any provision of the Act, and to publish and make available to the City of Cleveland and The Public Utilities Commission

of Ohio information as to whether Hope had violated the Act by charging an unlawful rate and by not charging a lawful rate. In addition, the Act expressly gave to the Commission blanket authority "to perform any and all acts * * * as it may find necessary or appropriate to carry out the provisions of this chapter."

From the expressly granted power to determine upon complaint of a municipality and upon its own investigation that the Act has been violated by charging an unlawful rate and by not charging a lawful rate, the jurisdiction of the Commission to determine a lawful rate for the immediate past is necessarily implied.¹

How could the Commission determine that the Act had been violated either by charging an unjust, unreasonable and unlawful rate or by not charging a just, reasonable or lawful rate, unless it could first determine a lawful rate?

The court below did not agree that under Section 4(a) it is an express violation of the Act to charge an unreasonable rate and not to charge a reasonable rate. The lower court took the view that "when rates were filed with the Commission pursuant to Section 4(c) of the Act they became the only lawful rates which the utility could charge or accept." (IV R. 202.) The majority below brushed aside the contention that "the legal rate was not made by the statute a lawful rate—it was lawful only if it was reasonable," upon the ground that the Natural Gas Act gives the Federal Power Commission no authority to award reparation. (IV R. 202.) There was no occasion for Congress to authorize the Federal Power Commission to award

¹ A determination of lawful rates for a period between the filing of the complaint and an initial Commission rate-fixing order, when not accompanied by any retroactive rate-fixing order, is, like an ascertainment of original cost and net investment under the Federal Water Power Act, an administrative matter, and not an exercise of judicial power. See *Clarion River Power Company v. Smith*, 59 F. (2d) 861 (1932) (C. C. A., D. C.), Cert. Den. 287 U. S. 639.

reparation to the ultimate consumers of gas—for whose ultimate benefit the Natural Gas Act was passed, see *Mississippi River Fuel Corporation v. Federal Power Commission*, 121 F. (2d) 159, 164 (1941) (Gardner, Circuit Judge)—because the award of reparation or refunds to ultimate consumers, like the fixing of future rates for ultimate consumers at burner tip, was left in the hands of the state commissions. As the opinion of the majority below stated, “It is to be noted that in the passage of the Public Utility Act of 1935, upon which the Natural Gas Act is modeled, provisions giving the Commission power to investigate single rates and issue reparation orders, originally incorporated in the bill, were stricken out, the Senate Committee saying in its report: ‘They are appropriate sections for a state utility law, but the committee does not consider them applicable to one governing merely wholesale transactions’.” (IV R. 201.) But the occasion for determining a lawful interstate rate different from a filed schedule rate for the immediate past is not confined to reparation cases. It also exists where, as here, the purpose of the Federal Act is to complement state regulation, see Natural Gas Act Section 1; *Public Utilities Commission of Ohio v. United Fuel Gas Company*, 317 U. S. 456 (1943) (Mr. Justice Frankfurter), and where the state regulatory bodies or courts may award reparation or order refunds on the basis of the Federal Commission’s determinations. e.g. Ohio General Code Sections 614-44 to 614-47; Pennsylvania Public Service Commission Act, Article 5, Section 5, Public Utilities and Carriers Service, Pennsylvania Volume, Section 112, page 170. *State ex rel. The City of Cleveland v. The Court of Appeals for the Eighth District*, 104 O. S. 96, 108-109 (1922).

The holding of the court below that the Federal Power Commission was not impliedly authorized to determine the lawful rate for the immediate past as an incident to the

expressly granted power to determine whether the Act had been violated by charging an unlawful rate and by not charging a lawful rate, is in conflict with the decision of this Court in *Atlantic Coast Line Railroad Company v. Florida*, 295 U. S. 301, 312 (1935) (Mr. Justice Cardozo) where the court said:

“* * * Unjust discrimination against interstate commerce, ‘forbidden’ by the statute, and there ‘declared to be unlawful,’ (Interstate Commerce Act, Sec. 13(4); *Board of Railroad Commissioners v. Great Northern Ry. Co.*, *supra*, at pp. 425, 430; *Florida v. United States*, 292 U. S. 1, 5) does not lose its unjust quality because the evil is without a remedy until the Commission shall have spoken. The word when it goes forth invested with the forms of law may fix the consequences to be attributed to the conduct of the carrier in reliance upon an earlier word, defectively pronounced, but aimed at the self-same evil, there from the beginning. The Commission was without power to give reparation for the injustice of the past, but it was not without power to inquire whether injustice had been done and to make report accordingly. * * *”

It is respectfully submitted that the jurisdiction of the Commission to determine lawful rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order is implied from the expressly granted power to determine upon complaint of a municipality and upon its own investigation that the Act has been violated by charging an unlawful rate and by not charging a lawful rate.

- B. The power to determine a reasonable and lawful rate for a reasonable period antedating the Commission's first order fixing rates for the future is implied from the expressly granted power to fix reasonable future rates.**

Under the authority conferred upon the Commission by Section 5(a) of the Natural Gas Act to fix rates for the

future (*Supra*, p. 3), the Commission was free to determine a reasonable rate for the period antedating its order. As a step in the process of fixing future rates, the Commission was authorized to consider and determine what rates were reasonable in the immediate past. This power to consider and determine what rates were reasonable in the immediate past, the Commission invoked in making its order fixing rates for the future. (I R. 68.) This Court has held under the section of the Packers and Stockyards Act, which is identical with Section 5(a) of the Natural Gas Act, that the administrative officer was free to determine the reasonable rate for the period antedating his initial order fixing rates for the future, for the purpose of making his order fixing rates for the future. In *United States v. Morgan*, 307 U. S. 183, 191 (1939) (Mr. Justice Stone), this Court said:

"Assuming, as appellees contend, that after the Secretary's order of June, 1933, was set aside he could, in the reopened proceeding, neither promulgate a rate order as of that date nor make an order for the payment of money, he was still not without authority in the premises under the statute and the mandate of this Court. He was free to make an order fixing rates for the future, and for that purpose or any other within the purview of the Act he is now free to determine a reasonable rate for the period antedating any order he may now make. See *Atlantic Coast Line R. Co. v. Florida*, 295 U. S. 301, 312. * * *

The power to determine a reasonable rate for a period antedating the Commission's first order fixing rates for the future is the power to determine a lawful rate. Not only does Section 4(a) of the Natural Gas Act expressly declare to be "unlawful" any rate that is not just and reasonable, but it mandatorily requires that "all rates * * * shall be just and reasonable." Section 4(c), when read together with Section 4(a), therefore imposes upon the natural gas company the affirmative duty of initially filing only a just and reasonable rate. The opposite interpreta-

tion adopted by the court below would have permitted the natural gas companies throughout the country to file initial rates of \$1 per thousand cubic feet, or other ridiculous amounts, and then keep such rates in effect while defying the Federal Power Commission, with its limited staff, to determine and fix just and reasonable rates to be effective only after many years. Hence, a filed initial rate is lawful only if it is just and reasonable. "In other words," as Mr. Justice Roberts said in *Arizona Grocery Co. v. Atchison Ry.*, 284 U. S. 370, 384 (1932), "the legal rate was not made by statute a lawful rate—it was lawful only if it was reasonable." And the power to determine a just and reasonable rate for the period immediately antedating the Commission's first order fixing rates for the future is therefore the power to determine a lawful rate for such period.

It is respectfully submitted that the power to determine a reasonable and lawful rate for a reasonable period antedating the Commission's first order fixing rates for the future is implied from the expressly granted power to fix reasonable future rates.

C. The holding of the Court of Appeals that the Federal Power Commission is without jurisdiction to determine lawful rates for a period subsequent to the passage of the Natural Gas Act and prior to an initial rate-fixing order thwarts and defeats the intent and purpose of the Congress.

The intent and purpose of the Congress was to stop the impairment of state regulation, including retroactive state regulation, arising from the influx of natural gas into the state of ultimate consumption at unjust and unreasonable rates primarily fixed by a holding company usually owning both the purchasing and selling subsidiaries.

The legislative history of the Natural Gas Act of 1938 and of the Public Utility Act of 1935, from which it stems,

show that Congress regarded the charging of unjust and unreasonable interstate rates between subsidiaries of the same holding company as a serious evil.

Senator Wheeler of Montana, Chairman of the Senate Committee on Interstate and Foreign Commerce, who had charge of the Holding Company Bill, S. 2796, commonly known as the Wheeler-Rayburn Bill, on the floor of the Senate explained (79 Congressional Record, Part 8, page 8383, May 29, 1935):

“* * * It (the Federal Trade Commission investigation) uncovered the practices of the holding companies which cannot be characterized in any other way, I submit without fear of contradiction, than as fraudulent and legalized thievery against the people of the United States.”

One of the counts in the Federal Trade Commission's indictment of the holding company referred to in the foregoing statement by Senator Wheeler was (79 Cong. Rec., Part 8, p. 8384):

“(11) Deceptive or illusory methods of dividing or pretending to divide earnings or profits.”

In the Congressional hearings on the Natural Gas Bill, the Solicitor for the Federal Power Commission testified that the greatest handicap of the state commissions in protecting the rate payer had been the growth of the holding company, the expansion of these utilities beyond state lines, and the failure of the Federal Government to help solve the problem. (Devane, Hearings H. R. 5423, 74th Cong. 1st Sess., Part 1, p. 498.)

The final report of the Trade Commission on the natural gas industry, one of the documents specifically referred to in Section 1(a) of the Natural Gas Act, concluded (Senate Document 92, Part 84-A, 70th Congress, First Session, p. 611):

“Twenty-two holding company groups are engaged in interstate transportation of natural gas.

“In 1934 *eight holding company groups* controlled about one-fourth of the supply of natural gas, and they

controlled approximately four-fifths of all natural gas moved in interstate commerce."

Mr. Ralph Gallagher of the Standard Oil Company (New Jersey) testified that purchase from affiliates is the situation in most large gas consuming states. (Gallagher, Hearings H. R. 11662, 74th Cong. 2nd Sess., p. 144.)

Judge Benton, Solicitor for the National Association of Railroad and Utility Commissioners, testified (Hearings S. 1725, 74th Cong. 1st Sess., April 16 to 29, 1935, p. 757):

"Where an operating public utility buys at arm's length from a producing company, it will buy as cheaply as it can. It may be compelled to pay an unreasonable price, but it will not pay more than it has to pay, but when it is under the control of a holding company it pays what it is told to pay."

The state commissions, standing alone, were frankly at a loss to prevent the spread through the holding company set-up of the evil of unreasonable rates for natural gas sold in interstate commerce at wholesale to burner tip in the state of destination. Representatives of municipalities and state commissions were practically unanimous in testifying that the right of state commissions recognized by this Court in *Dayton Power and Light Company v. Public Utilities Commission of Ohio*, 292 U. S. 290, 297 (1934) to inquire into the reasonableness of intercorporate transactions arrived at without arm's length bargaining and to disallow as operating expenses payments made in excess of the reasonable price, was inadequate as a remedy. They said this state right was inadequate because of insufficient funds, lack of power of subpoena running throughout the land, disparity of allowances approved in different jurisdictions, lack of control by the state commission in the state of distribution over the accounts of the producing affiliate in another state, and for other reasons. (Benton, Hearings H. R. 11662, 74th Cong. 2nd Sess., pp. 88-90.

95-98; Devane, Hearings H. R. 11662, 74th Cong. 2nd Sess., p. 153; Hoch, Hearings H. R. 11662, 74th Cong. 2nd Sess., p. 159; Reed, Hearings S. 1725, 74th Cong. 1st Sess., April 16 to 29, 1935, p. 698; Benton, Hearings 1725, 74th Cong. 1st Sess., April 16 to 29, 1935, p. 757; Smith, Hearings H. R. 5423, 74th Cong. 1st Sess., February, March, 1935, Part 1, p. 83; Benton, Hearings H. R. 5423, 74th Cong. 1st Sess., Part 3, p. 1654; see also *Elsbree, Interstate Transmission of Electric Power* (1931) (Harvard University Press), p. 119.)

In the debates on the Natural Gas Act, Senator Wheeler of Montana who had charge of the bill on the floor of the Senate as Chairman of the Committee on Interstate and Foreign Commerce, stated in response to a question from Senator Bulkley of Ohio (81 Cong. Rec. 75th Congress, First Session, Part 8, p. 9315):

"Mr. Bulkley: Mr. President, will the Senator explain just how this bill will improve the situation outlined by the Senator from Indiana (Mr. Minton)? That is the situation that we have in Ohio, and I am very much interested in it.

"Mr. Wheeler: It will improve the situation in this way: The Federal Power Commission will have power to regulate the price of gas shipped and sold at wholesale in interstate commerce, and so they will investigate and find out what is a fair price for it. The Senator's city of Cleveland, and other cities in Ohio, are helpless.

"Mr. Bulkley: The city of Cleveland uses gas imported from West Virginia; and the company which distributes the gas buys it in West Virginia from another corporation that is owned by the same people. How can we get around that?

"Mr. Wheeler: Simply because of the fact that under the bill, if the gas is shipped in interstate commerce, the Federal Power Commission has the right to investigate and say whether or not the company which ships it charges a fair rate for the wholesale

gas which it is selling to the city of Columbus or the city of Cleveland. At present that cannot be done. No one can say whether the price charged is a fair price, or whether it is a high price, or whether the city of Cleveland or the city of Columbus is being robbed. When efforts are made to get that information they are blocked by injunctions in the lower Federal courts, because it is said that the city has no authority over interstate commerce.

"Mr. Bulkley: I thank the Senator. I think the bill will be of great benefit."

In short, the history and conditions of the times as shown by the Congressional hearings and debates indicate that there was a widespread belief that the impairment of state and local utility regulation by the influx of natural gas from other states at prices fixed by holding companies without any arm's length bargaining between the purchaser and seller was an evil which had to be stopped:

To remedy this evil, Congress did three things. First, the Natural Gas Act outlawed from the date of its passage every interstate gas rate that was unjust and unreasonable, and imposed upon every natural gas company the duty of charging only just and reasonable rates from that day forward, Natural Gas Act, Section 4(a); House Report 709, House of Representatives, 75th Congress, First Session, April 28, 1937, Report to Accompany H. R. 6586, discussion of Section 4(a). Second, Congress authorized the Federal Power Commission to determine that any natural gas company had violated the Natural Gas Act by charging an unlawful rate or by not charging lawful rates, and authorized its minister to make such determination upon the complaint of any state, municipality or state commission, and further authorized the Federal Power Commission to make such information available to any municipality or state commission, thereby minimizing by the method of publicity (see *Valvoline Oil Company v. United States*, 308 U. S. 141, 146 (1939)). (Mr. Justice

Reed)) the effect of the unlawful element in the interstate commerce upon the economy of the state of destination. Third, Congress authorized the Federal Power Commission to fix just and reasonable rates for the future, thereby removing the unlawful element altogether from the interstate commerce. It must be implied from these express grants of power that Congress authorized the Federal Power Commission to determine lawful rates for a period subsequent to the passage of the Natural Gas Act and prior to an initial rate-fixing order, as an aid to state regulation.

The court below suggests that the Federal Power Commission's authority to fix interim rates, upheld in *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U. S. 575, 583 (1942) (Mr. Chief Justice Stone), negatives any intent on the part of Congress to confer upon the Federal Power Commission authority to determine lawful rates for a period subsequent to the passage of the Natural Gas Act and prior to an initial Commission rate-fixing order. (IV R. 202.) Of course, if the complaint of the City of Cleveland was right, the ideal arrangement would be for the Federal Power Commission to reduce Hope's rate to East Ohio the moment that complaint was filed. The state commission in Ohio could then have acted promptly in reducing the rates of the affiliated East Ohio Gas Company in Cleveland. But Congress must have known, and in fact was informed through the hearings concerning the state experience in natural gas regulation, that the necessary investigation in these natural gas rate cases takes years. Over two years after Cleveland's complaint was filed in this case—and it was the first complaint filed under the Natural Gas Act—the Federal Power Commission did not have sufficient information in its opinion to make an interim rate order. (*Supra*, p. 14.) And information as to reasonable and lawful interstate gas rates is a substantive statutory right of the state and local representa-

tives of the public interest for the years thus occupied by investigations and hearings, no less than for the future. This being so, and the Federal Power Commission being the tribunal to which municipalities, states and state commissions are referred as the ultimate guardian of the public interest in this field, it is a natural incident of the jurisdiction that the Commission should be free to make findings as to lawful rates for the period between the filing of complaints and an initial rate-fixing order fixing future rates. Congress did not seek to stop the impairment of state regulation arising from the influx of natural gas into the state of ultimate consumption at unjust and unreasonable rates primarily fixed by a holding company usually owning both the purchasing and selling subsidiaries only after the utilities had had a sporting chance for delay. Congress sought to aid state regulation beginning June 21, 1938, the effective date of the Natural Gas Act.

The holding of the court below does not support the purpose and intent of Congress but actually thwarts and defeats it. Since the passage of the Natural Gas Act, the state courts in Pennsylvania and the state commission in Ohio have held that the state commissions in Ohio and Pennsylvania are deprived by passage of the Natural Gas Act of all authority to require the distributing affiliates in Ohio and Pennsylvania to prove the costs of the producing affiliate in West Virginia in justification of the reasonableness of their interstate payments for natural gas. *Peoples Natural Gas Company v. Pennsylvania Public Utility Commission*, 14 A. (2d) 133, 35 P. U. R. (N. S.) 75 (Pennsylvania Superior Court) (1940); *East Ohio Gas Company v. Cleveland, P. U. C. O. Nos. 11,001, et al.*, R. 2958-2959 (Public Utilities Commission of Ohio). The upshot is that unless this Court holds in this case that the Federal Power Commission may determine lawful rates between affiliates subsequent to the filing of a complaint and prior to an initial order fixing interstate rates, the decision of the lower

court will result not in complementing state regulation, but in conferring self-regulation for several years after the effective date of the Natural Gas Act not only upon the interstate natural gas company in West Virginia, but also upon the local distributing affiliates in Ohio and Pennsylvania.

It is respectfully submitted that the Court of Appeals erred in holding that the Federal Power Commission has no jurisdiction to determine the lawful rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order, for the reason that said jurisdiction is implied from expressly granted powers, and is supported by the legislative history of the statute.

V.

THE COURT OF APPEALS FURTHER ERRED IN HOLDING THAT THE COMMISSION'S "FINDINGS AS TO LAWFULNESS OF PAST RATES" SHOULD BE SET ASIDE EVEN IF THE COMMISSION HAS JURISDICTION TO MAKE SUCH FINDINGS, FOR THE REASON THAT SAID FINDINGS HAVE A RATIONAL BASIS AND ARE SUPPORTED BY SUBSTANTIAL EVIDENCE.

The majority below held that "the findings as to past rates * * * should be set aside for the reasons heretofore given in discussing valuation and depreciation." (IV R. 203.)

It is submitted that the Court of Appeals thus erred in setting aside the Commission's "Findings as to Lawfulness of Past Rates" for the same reasons that it erred in setting aside the Commission's "Order Reducing Rates."

The Court of Appeals finally rested its decision upon the further ground that "the finding as to unreasonableness of these rates cannot be sustained because made on the basis of the utility's experience during the years in question, instead of upon a reasonable estimate of expense based upon experience of a prior period." (IV R. 203.)

This was the lower court's final error, because in determining lawful past rates the actual operating experience for the years in question is better than prophecy. *West Ohio Gas Company v. P. U. C.*, 294 U. S. 79, 82 (1935) (Mr. Justice Cardozo).

Dobie, Circuit Judge, dissenting below, rightly concluded (IV R. 207):

"For the reasons stated, I think the decision and findings of the Commission should be affirmed."

CONCLUSION.—

Upon a fair consideration of the record and applicable law we submit that:

1. The Court of Appeals erred in holding that the Commission's "Order Reducing Rates" and "Findings as to Lawfulness of Past Rates" are unconstitutional, for the reason, among others, that there is no constitutional question involved in this case.

2. The Court of Appeals further erred in setting aside the Federal Power Commission's "Order Reducing Rates" for the reason that said order is authorized by the Natural Gas Act, and is based upon findings which have a rational basis and are supported by substantial evidence.

3. Even if there were a constitutional question involved, as there is not, the Court of Appeals further erred in setting aside the Federal Power Commission's "Order Reducing Rates" for the reason that in the absence of an exercise of the power of eminent domain or other direct appropriation of property for the use of the United States Government, respondent was not entitled under the Fifth Amendment to anything more than due process of law.

4. The Court of Appeals erred in holding that the Federal Power Commission has no jurisdiction to determine the lawful rates for interstate sales of natural gas at wholesale after the effective date of the Natural Gas Act of 1938 and prior to the issuance of a Commission rate-fixing order, for the reason that said jurisdiction is implied from expressly granted powers, and is supported by the legislative history of the statute.

5. The Court of Appeals further erred in holding that the Commission's "Findings as to Lawfulness of Past Rates" should be set aside, even if the Commission has jurisdiction to make such findings, for the reason that said findings have a rational basis and are supported by substantial evidence.

Therefore, it is respectfully submitted that the judgment of the United States Circuit Court of Appeals for the Fourth Circuit should be reversed, and that the Federal Power Commission's "Order Reducing Rates" and "Findings as to Lawfulness of Past Rates" should be affirmed.

Respectfully submitted,

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